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Please note there is a handy "find" function which will allow you to search this book for any keyword or string of text you wish to locate. (Binocular Tool) Also note that there are hundreds of internal links, allowing you to jump from location to location. The table of contents and index are such examples. Although it may not seem obvious at first glance, you can find links by placing your cursor, which resembles a hand, over text, and if the cursor changes to a pointed finger, you know you have found a link. Throughout the book I commonly refer to other sections, usually something like the following:

"To learn more about balloon payments, please refer to the section titled "Balloons" found on page xx." **In this example, the word "Balloons" would be a link.** Watch for them as they come in very handy.

A Note to Readers: If you are requesting owner financing information so you can structure your own financing, to be purchased by an independent third party at the closing table, please note that while this book is written for lienowners, you can easily take the information provided here and use it for your own purpose. Pay special attention to the variables which impact a lien's market value, then structure your property purchase agreement likewise. The chances of having your offer accepted are greatly increased due to the high market value of the proposed lien. **Of course, we invite you to call our office(s) if you have questions.** (<--link.)

Enjoy!

Christen J Reinke

**How to Avoid the
10 Biggest Mistakes When Owner
Financing Real Estate**

Insider Tips To Save You Money and Time

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First Edition

**Capital Solutions Press
Anchorage, AK**

**How to Avoid the
10 Biggest Mistakes When Owner
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By Christen J. Reinke

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Why This Book Was Written

Well over half the notes which I review are poorly structured and an estimated 95 percent are not adequately maintained. Concern was thus the stimulus behind writing this handbook. I suspect that two variables are occurring simultaneously, resulting in such a high number of notes being poorly structured.

First, there is an overall lack of knowledge on behalf of lienholders. Second, real estate professionals who help structure owner-financed transactions also lack information regarding owner financing. *The secondary market is so new that the information in this book is not common knowledge.* The uneducated home seller thus not only ends up owning a poorly structured mortgage, they are never informed as to how to properly maintain the lien.

The goal of this handbook is therefore twofold. First, it is to supply lienholders and home sellers an easy-to-read reference guide for personal education. Second, it is to educate real estate professionals so they may better meet the needs of their clients.

As a pleasant surprise, a third came to my attention after it was written. Prospective home buyers were requesting owner financing information so they could propose and structure their own financing, to be purchased by an independent third party, at the closing table. This is called a simultaneous closing. It is a method of providing the home seller all cash at closing, while the home buyer avoids having to qualify for conventional financing. While this book is written for lienowners, home buyers can simply take the information provided here and use it for their own purposes. Pay special attention to the variables which impact a lien's market value, then structure your property purchase agreement likewise. The chances of having your offer accepted are greatly increased due to the high market value of the proposed lien. Of course, we invite you to call our office(s) if you have questions.

Acknowledgment

This handbook is dedicated to Phil and Amy, who were essential to its completion. Not only did they provide enthusiasm and encouragement, they also graciously gave of their time and energy to counsel, edit, and revise this publication.

Phil and Amy, this one's for you.

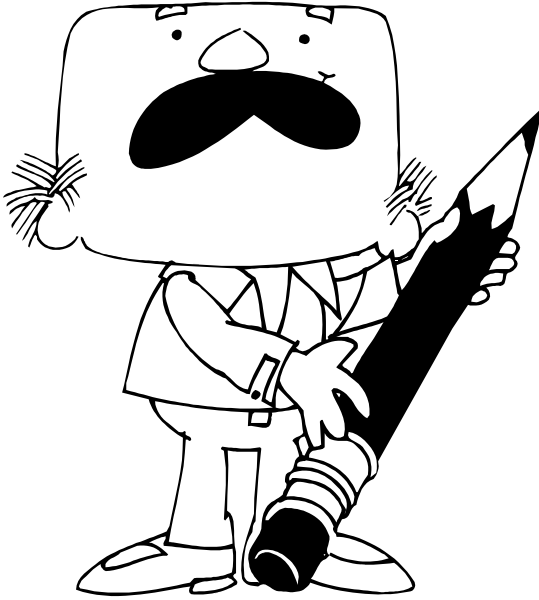
Disclaimer-Warning

This book is sold with the understanding that the author and publisher are not engaged in rendering accounting, legal, or other professional services. The reader is responsible for seeking the services of a competent professional authorized to render advice on taxes and other legal and/or technical issues. It is highly recommended that competent legal counsel be sought whenever you create an owner-financed note.

Great effort has been made to make this handbook as accurate as possible. However, there **may be mistakes** both typographical and in content. This text should therefore be used as an educational guide only, not as the final source of structuring and maintaining owner-financed liens. Additionally, this handbook only contains information regarding owner financed liens up to the printing date. You are encouraged to read all other available materials regarding owner financing, tailoring the information to your specific needs.

The author and publisher specifically disclaim any liability, loss, or risk, personal or otherwise, incurred as a consequence, directly or indirectly, of the use and application of any of the contents of this manual.

If you do not wish to be bound by the above, you may return this book to the publisher for a full refund.



1

How to Get the Most Out of This Manual

Most investments today come with some sort of owner's manual, like the one you received with your new car or computer. These manuals not only describe the asset in detail, they list what you as the owner need to do to prevent problems and optimally maintain the product. For example, in the case of a vehicle, the manufacturer suggests you change the oil regularly. However, when you sold your property via owner financing, you probably did not receive an owner's manual. You were not provided a description of the components that make up

your lien, nor were you provided suggestions on how to maintain its value and integrity. This manual is designed to fill that void.

In the process of exploring how to manage and maintain your lien, we will point out mistakes that are commonly made at the time liens are structured as well as after closing. Numerous tips and suggestions that will help you avoid these potentially expensive mistakes are found throughout this book.

In addition to learning common mistakes, you will also learn what variables determine lien value. This will allow you to structure and maintain a lien so that it will command top dollar if you need to sell at any time in the future. *You will, in essence, know more than most real estate agents and can avoid being kept “in the dark” by perhaps a well-intentioned, but poorly educated real estate professional.* Please remember, the information in this book is not common knowledge for real estate agents, due to the fact that most agent training only lightly touches on the subject of owner financing. To encourage you to “educate” your agent, we offer wholesale discounts.

The Layout of This Publication

In the next chapter, “Answers To Basic Questions,” you will learn about a dramatic change concerning owner financing which has occurred in recent years. The content of this book is based upon this profound change. This section will also answer a few technical questions in an easy-to-read format, providing you with the foundation needed to fully understand the following chapters.

The third chapter explores the key ingredients found in most mortgages, land contracts, and deeds of trust. Here you will learn what these key ingredients are, how they affect you, and what to do in case of default. In addition you will find numerous hints on how to maintain your note. Property purchasers who want to learn what variables create a highly valued lien will find this chapter valuable, as you will begin to understand the viewpoint of lienholders and can anticipate their concerns.

In the fourth chapter, “Selling Property Via Owner Financing,” you will learn “insider tips” that can save you both money and time. Readers who have not yet structured a lien will learn how to evaluate property purchasers, decrease their risk, and create a lien which will command top market value. Readers who already own a lien will learn how to maintain their lien, what things they should look out for, as well as what they could have done differently and why. Property purchasers will find this chapter valuable as the items which create or negate lien value are discussed. By building as many “value enhancing” variables into your proposed lien as possible, you will increase the chances that your property purchase agreement is accepted by the property seller.

For best results, use the information in chapter four with the information supplied in chapter three. These two chapters are the heart of this book and have been cross-referenced to compliment each other. By the time you have completed reading through chapter four, you will understand the top 10 mistakes made by lienholders and how you can avoid and/or prevent these mistakes. For easy reference, a summary of the top ten mistakes is found at the end of this chapter. This convenient

guide will show you where to find information pertaining to each mistake.

The fifth chapter, “Getting Started,” consists of a tax and insurance maintenance form, which is key to maintaining your note. An estimated 95 percent of our clients fail to maintain their notes properly. As a result, we suggest you use this form religiously; it is an important part of a good note maintenance plan. You will also find within this section an index of security instruments by state as well as a brief question-and-answer section on how to sell all or part of your note for cash.

The last chapter, “Additional Services,” provides you information on how to contact the author, additional services offered by Capital Solutions, and how to provide this handbook to a friend at a wholesale price.

Before Beginning

Before you begin, take out the paperwork for your note so you can follow along as you read the chapter titled “Key Ingredients of Your Note.” You will find free space along the left-hand side of each page so you may write in your own notes and “To Do” reminders. It will thus be easy for you to review your notes once you are done reading.

Also before beginning, please familiarize yourself with the glossary and index that start on pages 125 and 131, respectively. Real estate involves a lot of terminology, and although care was taken to leave out much of this terminology, you may not be familiar with some of the words in this manual. We thus urge you to locate the glossary and index before you begin reading. You may want to put a tab or marker at the beginning of these sections.

For easy reference, each section ends with a bulleted list of tips and highlights.



The “bright idea” symbol indicates a *Tips and Highlights* section.

Please store this manual with your property files and keep it as long as you own your note. We strongly suggest you purchase an annual calendar and schedule a time to review this manual next year. Frequent review of this material is the best way to learn it and the best way to keep your options fresh in your mind.

Did You Know?

A great place to perform legal real estate research is at First American Title Companies Underwriting Library:
“<http://ul.firstam.com/>”.



2

Answers to Basic Questions

What Is a Security Instrument?

“Security” essentially means protection or assurance. The term “instrument” refers to a formal document. A security instrument, therefore, is the same thing as a protective document. It is a document that provides evidence of indebtedness and thus protects the rights of the person to whom debt is owed.

For example, pledges, liens, mortgages, and deposits are all obligations that may require the use of a security instrument. Should the person who owes the debt fail in his or her obligation, the party who is owed debt can use the security instrument to recover his or her investment.

This manual refers only to security instruments involving owner-financed real estate. It does not refer to other security instruments such as those used by banks to secure vehicle or boat loans.

What Are the Different Types of Security Instruments?

Different terms are often used to describe a single concept. For example, the terms “car” and “vehicle” both describe the concept of an automobile. In the same manner, different terms describe the concept of owner financing. The following commonly-used terms are synonymous. They all refer to your owner-financed lien:

- Contract
- Contract for Deed
- Note
- Lien
- Seller Carry-Back Financing
- Carrying Paper
- Privately-Held Mortgage
- Installment Land Contract

Furthermore, just as many terms are used to describe the different “makers” of automobiles, such as Ford,

Chevy, or Toyota, different terms are used to describe the different “make” of security instruments:

- Mortgage
- Deed of Trust
- Installment Land Contract
- Trust Deed
- Security Deed

How Can One Manual Apply to All These Types of Security Instruments?

In general, all security instruments are alike in terms of intent and/or function. This common denominator allows for the exploration of general topics. Therefore, the contents of this manual will apply to you and your security instrument, whatever that may be.

“Deed of trust” will be the term most commonly used throughout this manual. If your security instrument is something else, such as a mortgage, simply substitute the term “mortgage” for “deed of trust” as you read.

Do All Security Instruments Pass Title From the Property Seller to the Property Buyer?

No. The most common security instrument in which title is not passed to the property buyer is the land contract. Installment land contracts do not pass title of the property to the new property owner until the lien has been paid in full. Should default occur, it can therefore be easy for the lienholder to take back the property.

Why Is My Security Instrument Different From My Neighbor's?

The answer to this question may involve state law. Different states allow the use of different security instruments. Regardless of what “make” of security instrument you own, you will find this manual applies to you since all security instruments function alike in terms of intent.

How Is Owner Financing Different Today Than it Was Yesterday?

One of the most dramatic changes that has occurred in the past few years is the securitization of owner-financed liens. This means that securities backed by large pools of owner-financed liens are being sold to the public.

As such, investors are competing heavily for the opportunity to purchase all or part of your deed of trust. *This means that if you plan on “carrying paper” in the future, you would be wise to structure your note so that it will demand top market value if the need to sell ever arises. If the need to sell does not arise, you can rest assured that you have created a note that meets the top standards of this new industry.*

Since most people who finance the purchase of a property would have preferred to receive all cash at closing, lienholders like yourself are happy to learn that one of the most dramatic benefits of securitization is an increase in the cash value of privately owned notes. By

the time you finish this manual, you will understand the key ingredients of your note and how those ingredients can affect its resale value.



Tips and Highlights

- Due to securitization, you can now sell your note for much more cash than you could have sold it for ten years ago.
- If you plan on “carrying paper” in the future, you would be wise to structure the note so it will demand top market value if the need to sell ever arises.

What Does it Mean to “Assign” My Interest to Someone?

The term “assign” simply means to transfer something from one party to another. As a note owner, you have the ability to assign interest in your note to a third party. Examples of when this might occur include selling your note to someone or using your note as a down payment to purchase a new home.

Assignments can be in full or in part. If you assign your note to a third party in full, you no longer retain interest in the note. This means you are not entitled to the right to receive any more of the payments. If you assign your note in part, you still retain some interest in the note and may receive payments along with another party.

Assignments, like many real estate documents, are very flexible and thus can be structured many different ways.



Tips and Highlights

- As a note owner, you have the ability to assign interest in your note to a third party.
- Assignments can be in full or in part.

What Are Some Key Terms I Need to Know?

Following are some key terms you should familiarize yourself with before continuing:

Payer: This term refers to the property owner, the person making the payments. Also spelled “payor.”

Payee: This term refers to the person receiving the payments, often the person who has sold property via owner financing.

Interest: This is synonymous with a right or entitlement. For example, you can assign interest in your note to a third party. This means you assign your right to receive the payments to someone else.

Senior Lien: This is simply a lien on a given piece of property that has been recorded before another lien on the same piece of property. Another way of stating this is to say that a senior lien is “positioned” ahead of a junior lien. This means that it is superior to liens that were recorded after it was recorded. For example, a lien recorded in 1996 is senior to a lien recorded in 1997. Lien positions are important issues, particularly in reference to foreclosure.

Junior Lien: This is a lien which was recorded after a previous lien. For example, if the lien you own was recorded after two other liens on the same piece of property, you are the owner of a third-position lien. Owning a junior lien is much riskier than owning a first position lien because junior liens have fewer legal rights than a lien in first position. The rules governing junior liens are complicated and can vary from state to state. For more information please refer to the section titled “Junior Liens” beginning on page 74.

Restructuring a lien so that the monthly payment is increased can be a great way of increasing your return on investment, while saving the payer interest. A true win-win arrangement.



3

Key Ingredients of Your Note

The following section provides information on the key ingredients found within most liens, regardless of whether they be mortgages, deeds of trust, or land contracts. The order in which these ingredients appear will differ from contract to contract, so do not be alarmed if the layout of your contract varies significantly. After reading this section you should understand what these key ingredients are and how they can affect the value of your contract.

Parties to the Contract

This section defines who the “parties” in the contract are; that is, the persons who are entering into the contract. The seller and purchaser of the property are called by different names in different types of security instruments, as shown in Table 1.

Table 1: Seller and Purchaser by Type of Lien

| Type of Lien | Seller | Purchaser |
|---------------|-------------|-----------|
| Deed of Trust | Beneficiary | Trustor |
| Mortgage | Grantee | Grantor |
| Land Contract | Vendor | Vendee |
| Trust Deed | Beneficiary | Trustor |

In addition to naming the parties, this section will include the date the contract takes effect as well as the date on which interest begins to accrue. Unless otherwise specified, the accrual date is the date the contract takes effect. However, like all variables, the accrual date is negotiable and some purchasers will attempt to defer it, thereby minimizing the amount of interest they will pay.

Since interest usually begins to accrue when the contract takes effect, by the time the first payment is due, one month’s interest will be owed. In other words, every time a payment is made part of that payment is applied to interest accrued the preceding period. A payer who has missed payments may find it difficult to bring the account current because he or she owes a lot of back interest. You should thus take immediate action the moment a payment is late. The longer you wait, the more costly the situation will be. For more information on default, refer to the section titled “Default” on page 47.



Tips And Highlights

- In this section of your deed of trust, write in the owner's home and work telephone numbers, particularly if they are unlisted.
- Take immediate action the moment a payment is late.

Legal Description

It is within this section that the encumbered real estate is defined. The applicable city, village, or township, along with the county and state, are noted here. This formal legal description can be lengthy, particularly when a condominium or an unusual property is concerned.

Along with the actual ground, the purchaser receives everything that is permanently affixed to the property. This would include structures, easements, hereditaments, improvements and appurtenances. (If you haven't located the glossary, which begins on page 125, now would be a good time).

In this section of your deed of trust, write in the "Tax ID" number for the property. This will make it easier for you to check that taxes have been paid, since most tax offices reference properties by "Tax ID" numbers. In addition, turn to the Tax and Insurance Maintenance form on page 111 and record the Tax ID number here as well. Also jot down the purchaser's mailing address if it is different from the collateral and/or it is not listed in this section.



Tips and Highlights

- In the legal description section of your contract, write in the “Tax ID” number for the property.
- Turn to the “Tax and Insurance Maintenance Form” on page 111 and record the Tax ID number in Section A.
- In the legal description section of your contract, jot down the purchaser’s mailing address if it is different from the collateral and/or it is not listed in this section.

Price and Terms of Payment

Price and term information may be located differently within your contract depending on what type of security instrument you own. For example, in the case of a deed of trust, this section is found in the Deed of Trust Promissory Note. If your security instrument is a Land Contract, this section is found within the land contract itself. Regardless of what type of instrument you own, the following information is detailed within your document(s):

- The beginning balance (i.e., the purchase price minus the down payment)
- The payment, expressed as principal and interest (P&I)
- The annual interest rate (e.g., 10%)
- The date of the “balloon” payment, if any
- The date the first payment is due

Balance Remaining

The balance remaining is calculated by subtracting from the sales price the down payment and/or other consid-

eration such as traded or bartered items. The balance remaining should decrease with each payment.

A Word on Down Payments

The larger the down payment, the better. Obtaining a substantial down payment is the number one thing you can do to protect yourself. It also increases the value of your note.

You want the purchaser to have a strong monetary investment and therefore commitment to the property. A down payment is money that is paid at closing, does not have to be collected in uncertain future payments, and represents the purchaser's commitment to the property. Properties that are purchased without down payments are thus very risky. For this same reason, down payments that are spread out over time or borrowed from a third party also present great risk.

You may receive phone calls from prospective purchasers who want to buy with no money down. Do not allow this, unless you thoroughly understand foreclosure and are willing to take such a high risk. Make sure you adequately communicate to the prospective buyer the minimum down payment you will accept.

For additional information on this subject refer to the section titled "The Down Payment" which begins on page 44. You may also refer to page 55.

Monthly Payment

This figure usually is about 1 percent of the beginning balance. Here is an example: If the principal balance of your note is \$50,000, and the interest rate is 9 percent amortized over fifteen years, then the monthly pay-

ment will be \$507.13, which is roughly 1 percent of \$50,000.

The monthly payment may or may not include funds to cover taxes and insurance. See the section titled “Taxes and Insurance” which begins on page 34, for an in-depth look at your options regarding this issue. Regardless of whether the monthly payment includes the cost of tax and insurance, the balance owed should decrease with each payment.

Do not create a note that negatively amortizes. This occurs when the amount of each payment does not cover the interest accrued and the difference is added to the principal balance. The balance therefore increases rather than decreases. Creating such a note decreases its cash value dramatically. Such notes usually will need to be restructured before an investor will purchase them.

Keeping track of monthly payments can be tiresome. For information on account servicing companies, please refer to the section titled “To Use or Not to Use a Servicing Company” which begins on page 93.

Payment Due Date

This is the date when the first payment is due. It is a negotiable variable, just like the purchase price. Also negotiable is a “grace period.” You may charge the payer a late fee if the payment is not received on time or within the grace period. However, this charge must be included in your note for it to be legally binding.

Do not allow the payer to habitually make payments late. Insist on promptness. Late payments decrease the value of your note; they are an indication of the financial weakness of the payer.

A hefty late charge is a good way to encourage promptness. For more information on what to do if a payment is late, please refer to the section titled “Default,” beginning on page 47.

Balloon Payments and Their Hidden Benefits

A balloon payment refers to a large, final payment. Balloons usually have a due date five to ten years from the date of sale but are negotiable like other variables. You don't want to make the balloon too close to the date of sale, because most payers will not be able to refinance or come up with the required amount of money in such a short period of time.

Balloon payment clauses may read as follows: “On the ____ day of ____, (year) the entire sum of principal and interest then owing shall become due and payable in full.”

There can be a couple of “hidden” benefits to balloon payments. Should the owner be unable to make the balloon payment, you have the opportunity to refinance the lien. You may want to increase the interest rate or monthly payment, or both. Doing so usually increases your return on the investment. You are then able to set a new balloon payment date and avoid a messy foreclosure.

However, increasing your return on investment is not the only benefit to revising the term and/or interest rate. The market value of your note, should you ever need to sell all or part of it, has increased as well. This is a true “win-win” situation for both you and the property owner.

Since balloon payments abbreviate the amount of time it takes investors to recoup their investments, balloons tend to increase the value of a note. An exception to this is when balloons are structured poorly. Please refer to the section titled “Balloons” which begins on page 57, for additional information on this subject.

It is a good idea to notify the payer in writing six months before the balloon payment comes due and payable. This gives him or her enough time to refinance or make other arrangements.

Annual Interest Rate

Each payment is composed of two main components: interest and principal. Payments may or may not include taxes and insurance; however, in either case interest is based on the remaining principal alone.

Interest (I) is calculated for the payment period by multiplying the annual interest rate (R) by the principal due (P) and then dividing this annual interest amount by the number of payments (N) to be made each year. This number, the total interest for the period, is then deducted from the payment. The rest of the payment, minus taxes and insurance if they are included in the payment, is known as the principal. This portion is deducted from the principal balance remaining on the note. For those of you who like formulas, interest is calculated as follows:

$$I = (R \times P) / N$$

Here’s an example: Suppose the beginning principal on an owner-financed note is \$75,000, payable with monthly payments of \$723.77 at an interest rate of 10 percent. Assuming this monthly payment does not in-

clude taxes and insurance, you can calculate the amount of interest paid in the first monthly payment as follows. Multiply the principal balance by 10 percent, then divide that number by 12, the number of payments per year.

$$\text{Monthly Payment} = (.10 \times \$75,000) / 12$$

Thus the interest amount of the first payment will be \$625, and the principal portion will be \$98.77.

$$\begin{aligned} I &= \$7,500 \text{ divided by } 12 \\ P &= \$723.77 \text{ minus } \$625 \end{aligned}$$

The new principal balance will now be \$74,901.23.

$$\$75,000 \text{ minus } \$98.77$$

Should the buyer make an extra payment toward the principal, you would simply subtract the amount of extra principal paid from the new principal balance. For instance, suppose that in the previous example the buyer pays \$1,723.77 instead of \$723.77. In this case, the buyer has paid an extra \$1,000; thus the remaining principal will be \$73,901.23.

$$\$74,901.23 - \$1,000 = \$73,901.23$$



Tips and Highlights

- The larger the down payment, the better. Obtaining a substantial down payment is the number one thing you can do to protect yourself. It also increases the value of your note.

- Do not create a note which negatively amortizes. Regardless of whether the monthly payment includes the cost of tax and insurance, the balance owed should decrease with each payment.
- Do not allow the payer to habitually make payments late. A hefty late charge is a good way to encourage promptness.
- There can be a couple of “hidden” benefits to balloon payments, such as increasing the value of your note and increasing your return on investment should the payer fail to make the balloon payment.
- It is a good idea to notify the payer in writing six months before the balloon payment comes due and payable. He or she can then plan accordingly.
- Using amortization computer software is the easiest way to calculate interest.

Taxes and Insurance

Before discussing two common methods of handling taxes and insurance, let’s first take a look at what is included in most tax and insurance clauses.

Insurance Clause

Most insurance clauses require that the property owner purchase fire insurance on all buildings, both new and existing. The purpose of this insurance is to protect you, the grantee, from loss as a result of fire. You will thus be named the beneficiary of the policy, even though the policy was purchased by the property owner. If a loss occurs due to fire, you will receive payment from the insurance company ahead of the property owner.

The amount of insurance coverage purchased should be no less than the total debt owed to you. If a property is insured for less than the debt owed to you and it burns down, the insurance payout will not cover the full principal amount owed to you, nor will there be anything left over for the home owner.

If the property resides in a flood zone, tornado zone, or other risky area, you may be able to safeguard against loss from these hazards as well. Depending on the cooperation of the property buyer and state law, you may be able to add a clause to your security agreement that requires additional insurance to protect against hazards such as flooding or earthquakes. Furthermore, you can require that the purchaser buy insurance that covers the current value of the property, not just the remaining principal. Please refer to the section titled “A Word on Hazard Insurance” beginning on page 64 for information regarding insurance and how to make sure you are protected.

Tax Clause

This clause requires the payer to pay taxes and assessments before they are due and to keep the property free and clear of other liens and encumbrances that may impair the security of the deed of trust. An example of this would be unpaid property taxes.

You can opt to place an additional clause into your contract that requires the payer provide you annual proof of tax payment. See the section titled “Special Clauses” which begins on page 100 for further information.

Methods of Handling Taxes and Insurance

There are two common methods of handling taxes and insurance:

1. The property owner is responsible for taxes and insurance.
2. The property seller pays taxes and insurance out of amounts put into an escrow account by the property owner.

The most common method of the two is the first one, whereby the owner is responsible for taxes and insurance. The second method is to have the monthly payment include reserves for taxes and insurance. With this option, approximately one-twelfth of the estimated annual taxes and insurance is added to each monthly payment. These reserves will typically go into an escrow account, accumulating until taxes and insurance are paid. Thus the monthly payment will adjust from time to time, either increasing or decreasing as tax and insurance costs increase or decrease. This method involves active participation from you, the note owner, since you will have to notify the property owner of changes in the monthly amount, should any occur.

If you choose this option, it is a good idea to keep tax and insurance funds in a completely separate non-interest-bearing account at the bank. This makes it easy to determine when adequate funds are available to pay the bills owed.

If you choose to let the payer assume responsibility for tax and insurance payment, schedule one day a year to check for yourself that the property owner has paid all the required taxes and insurance. Failure to pay taxes

is not only a breach of contract, but it is also an indication that the owner may not be able to afford the property. Foreclosing on a property only to discover that the first expense you have is several thousand dollars of unpaid back taxes can be quite disheartening.

In summary, these two options are the most common methods of handling the tax and insurance issue. The first method is slightly risky for you as a note owner, since you do not directly pay taxes and insurance. However, if you are diligent about checking on the payment of these items, that risk is somewhat minimized. The second option is one in which the note owner keeps track of tax and insurance reserves, often accumulating into a separate account. This method decreases your risk because you ultimately control the final payment of these bills.

It is a good idea to buy a yearly calendar and schedule a day to call the tax office. Use the form in the back of this manual to record these phone calls. For more information regarding taxes and insurance, see the section titled “Tax and Insurance” which begins on page 61.



Tips and Highlights

- The purpose of hazard insurance is to protect you, the note owner, from loss if the property used to secure your lien burns down.
- The amount of insurance coverage purchased should be no less than the total debt owed to you, and could be as much as the current value of the property if you require this within your security instrument.

- If the property resides in a flood zone, tornado zone, or other area at risk of a natural disaster, you may be able to safeguard against loss from these hazards by requiring that the property owner purchase insurance protecting against such hazards.
- It is a good idea to place an additional clause into your contract which requires the payer provide you annual proof of tax payment.
- Failure to pay taxes is not only a breach of contract, it is an indication that the owner may not be able to afford the property.
- It is a good idea to buy a yearly calendar and schedule a day to call the tax office. Use the form in the back of this book to record these phone calls.

Care of the Property

Within your security instrument will be a paragraph called the Care Clause. This clause requires that the property owner(s) protect the value of the property until it is paid in full.

Protecting the value of the property is an important issue, because property value is an incentive for the payer to continue to make payments. The greater the property value, the greater the incentive.

Property value also is a key issue for you as lienholder. Should foreclosure occur, the value of the property will determine if you are able to recoup your investment without a loss.

To make sure the goal of protecting property value is accomplished, a care clause should include the following:

- It should require the property owner to notify you, the note owner, in writing before committing waste or making any changes to the premises in a manner that may diminish the value of the property.
- It should state that it is the owner's duty to keep the property in good condition as well as to complete any building, structure or improvement being built or about to be built. In other words, the owner cannot allow a building to deteriorate in value through a lack of maintenance, nor can he or she begin constructing a new structure and fail to complete it.
- It should state that the owner cannot permit waste (i.e., any structure or improvement that may be damaged or destroyed must be restored.) For example, if a property is damaged by a storm, the owner is required to fix the damage.
- It should also require that the owner comply with all laws, ordinances, regulations, covenants, conditions and restrictions affecting the property. For example, the property owner cannot sell drugs out of the property since this violates federal, state, and local laws.

The care clause is meant to protect you as lienholder, and you should therefore take advantage of the protection this clause provides. It is a good idea to drive by the property once a month, since deferred maintenance usually is one of the first signs of financial stress. We at Capital Solutions feel that the degree to which a prop-

erty owner cares for his or her property is highly reflective of the strength of their commitment to pay it off. Being aware of neglect or damage will allow you to take prompt action.

It is not uncommon for a property owner to continue to make timely payments but neglect property maintenance. If you are not driving by the property on a regular basis, you will be unaware of such neglect.

Also be aware that the value of your note will often decline in direct correlation to the value of the property. Thus, as the value of the property declines, so will the value of your note. There are two main reasons for this:

1. As the property value decreases, the property owner's interest in the property decreases. This increases the likelihood of a foreclosure.
2. As property value decreases, the amount the note owner can recover through foreclosure also decreases.

If you suspect the property owner is not fulfilling the requirements of the care clause, you should seek the counsel of a competent real estate attorney. The definition of "waste" can be broad, depending on the state where the property is located. It is therefore a good idea to see an attorney who practices within the state in which the property is located.



Tips and Highlights

- Property value is an incentive for the payer to continue to make payments. The greater the property value, the greater the incentive.
- Should foreclosure occur, the value of the property will determine if you are able to recoup your investment without a loss.
- It is a good idea to drive by the property once a month, since deferred maintenance usually is one of the first signs of financial stress.
- If you suspect the property owner is not fulfilling the requirements of the care clause, you should seek the counsel of a competent real estate attorney.

Payment or Satisfaction

After your note has been paid in full, a document called the *deed of reconveyance* will be delivered to the property owner. This deed releases your lien from the property.

Specifics regarding the satisfaction of your lien will vary depending on the security instrument you own. However, the general idea is that after your lien has been paid in full, your lien is released from the property. Often a title company or the company that has been servicing your lien will handle this for you.

Assumption of the Deed of Trust

As a note owner you have the ability to assign your interest in your note to another party without notifying the property owner. Situations like this may occur when you need a lump sum of cash instead of small monthly payments. Refer to the section titled “Selling All or Part of Your Note for Cash” beginning on page 113 for more information on how you can sell a few payments or all of the payments of your trust deed for cash.

Although as a note owner you can transfer your asset to another party, property owners normally do not have these same rights without first obtaining consent from you. If your note is assumable, (i.e., the property owner can sell the property to another party who assumes payment of your lien), you should require that the property owner receive written authorization from you before the assumption is officially recorded. Make sure this clause is in the security instrument. Do this regardless of whether or not the security instrument includes a “due-on-sale” clause. The following section explains this point further.

A Word on the Due-On-Sale Clause

A due-on-sale clause gives the lender the right to demand payment of any remaining principal due on the loan when the property is sold. This clause is a powerful tool designed to stop unwanted assumptions.

However, you need to understand that a due-on-sale clause is a contractual right, not a law. This means that property owners will not go to jail for violating this clause. It also means that you, as a note owner, may not choose to call the loan due and payable, thereby allowing an assumption to occur. Using a due-on-sale

clause is thus a good idea since it can be waived, per your discretion, should you have confidence in the new purchaser.

If you have not been maintaining your lien you could find that the property has been sold without your knowledge, even if you have placed a due-on-sale clause within the contract. Unfortunately, this occurs more often than you may think. This is another reason why you need to perform regular maintenance on your lien. Usually either the property tax office or the insurance company will know who the new property owners are. If you believe the property owners defaulted on any clause within your contract, always seek the counsel of a competent real estate attorney.

Regardless of whether or not you have a due-on-sale clause, make sure that your written authorization is required for an assumption to occur. Should the property owner ask for authorization to assign interest to another person, you may want to gather the following information before consenting to the assumption.

- Credit report on the prospective purchaser
- Employment information on prospect
- Down payment information
- New sales price information

Credit report on the prospective purchaser

Obtain at least one credit report on the prospect. The reason you may want to review more than one credit report is that sometimes different agencies pull up different information on the same person. These differences are sometimes remarkable. Never allow the prospect to obtain the credit report(s) for you. For addi-

tional information on credit reports, see the section titled “A Word on Credit Reports,” beginning on page 68.

Employment information on prospect

Gather employment information and verify all employment facts yourself. Obtain the most recent pay stub available from the prospect, and if he or she is a first time home owner, you may want to obtain rental payment history.

Down payment information

Inquire about the exact down payment the prospect will bring to the closing table should you consent to the assumption. You want to have a minimum of 10 percent down, although we recommend a down payment of 20 percent. If you are uncomfortable with the limited amount of down payment the purchaser can afford, you should consider selling your note at the closing table, so that your risk as lienholder becomes zero. For more information on this option, see the section titled “Selling All or Part of Your Note For Cash,” beginning on page 113, or call us at 1-888-372-9993 or 1-800-931-0979. There are programs available for purchasers with less than 10 percent down.

New sales price information

Inquire about the sales price in the new transaction. You do not want the property to be sold under-value or over-value since this can also affect the value of your note.

The Down Payment

Failing to obtain a minimum of 10 percent down, as well as allowing the property used as security for your note to be sold under-value or over-value, are hidden risks that many lienholders are unaware of.

A substantial down payment is the number one thing you can do to minimize your risk. This is your protective equity. Should you need to foreclose, it is the main factor that will determine whether you can recover your investment without a loss. If the owner has little or no equity, you may be lucky to recover any money after paying foreclosure costs, real estate commissions, possible back taxes, and money spent fixing up the property during the foreclosure period.

Furthermore, a down payment of less than 10 percent can greatly increase the amount of risk associated with your note. In order to compensate for this risk, investors will offer to pay less for your note and thereby “build back in” the protective equity, which would have been accomplished by an adequate down payment. It is a general rule, therefore, that the greater the down payment given at closing, the more your note will be worth.

When you consent to an assumption, it is a good idea to have your written consent stipulate that the assumption is contingent upon whatever minimum down payment you decide is prudent. Make sure this contingency is in writing. Changes to the sale price and down payment can occur right before closing. Having your consent in writing will prove what you did or did not consent to.

Better yet, stipulate the minimum down payment you will accept, should you consent to a future assumption, within your deed of trust. This way the property purchaser understands in advance what your requirements will be for an assumption to occur.

The Sales Price

The sales price of the property in the new transaction is also important. You do not want the property to be sold under its actual value. In general, suspicions are raised when a property being sold via owner financing does not bring a medium-to-high sales price. As a result, most investors are reluctant to use the appraised value of a property when determining how much to pay for a note, within 12 to 18 months after a sale. Therefore the value of your note may be based on the sales price, not actual worth, if sold within 12 to 18 months of the assumption. However, after 12 to 18 months the value of your note often is based on an independent appraisal rather than the sales price.

Allowing the property to be sold over value is another problem you should look out for. An overpriced property may indicate the payer agreed to pay more for the property in exchange for a small down payment. A payer who develops financial problems is more likely to abandon the property since he or she has little or no equity. It is never in your best interest to allow an assumption to occur where the sales price is either under or over current market value. For more information regarding this topic please refer to the section titled “The Down Payment” beginning on page 44.



Tips and Highlights

- Using a due-on-sale clause is often a good idea since it can be waived if you have confidence in the prospective buyer. If you do not, you can exercise your option, thereby calling the loan due.

- If your note is assumable, require that the property owner obtain written authorization from you before the assumption is officially recorded.
- Allowing the property used as security for your note to be sold under value, over value, and/or failing to obtain a minimum of 10 percent down, are hidden risks that many lienholders are unaware of.
- Gathering the following information will help you decide whether to consent to the assumption of your note:
 1. Credit report on the prospective purchaser
 2. Employment information on prospect
 3. Down payment information
 4. New sales price information
- Stipulate the minimum down payment you will accept, should you consent to a future assumption, within your deed of trust. This way the property purchaser understands in advance what your requirements will be for an assumption to occur.
- It is a general rule that the greater the down payment given at closing, the more your note will be worth.

Default

Default occurs whenever the payer fails to fulfill the obligations of the contract. These failures may include failure to provide insurance coverage, failure to pay taxes as they become due, or failure to maintain the property. The most common and obvious default is failure to make timely payments. Should a payment be late, the following steps are recommended:

1. Check to see if a “grace” period exists. If so, honor it.
2. If no grace period exists, or if it has expired, phone the owner and inquire about the payment. Since it is late, insist on payment with a certified check or money order. Late payments increase the chance of a check bouncing. Always record the date and time of the call as well as with whom you spoke. Keep this information in your property file.
3. That same day, write a letter identifying the default, summarizing any action the owner has promised to perform. Mail this letter certified, return receipt requested. For those in a Deed of Trust state, you may request this letter be written and sent by the Trustee.
4. If the above steps do not remedy the situation, contact an attorney immediately. Attorney fees are a small expense compared to the possible consequences of taking action without consulting an attorney. Further contact with the property owner could aggravate the situation.

Declaring a deed of trust to be in default is a serious matter. A competent real estate attorney should be used, one who is familiar with state law where the property is located. Do not delay taking action. In some cases, failure to enforce your contract (over a period of time) can take precedent over the actual wording in your security. **In other words, failure to enforce your security instrument can establish precedent that the clause in question has no effect and therefore is not binding.**

If you choose to do nothing and wait, you should investigate the condition of the property. If there is substantial damage to the property, you could be liable for injury to others by doing nothing.

If you choose to hire an attorney, do not assume that foreclosure is eminent. There may be a creative and practical solution to the problem. *Your attorney may counsel you to simply revise your security instrument and/or the terms of repayment so that you are better protected.* This is a common solution. Your options, in part, are determined by the cooperation of the payers, or the lack of it. Many payers will welcome an alternative to foreclosure, particularly if they have equity in the property. Always ask your attorney what your options are before assuming that foreclosure is the only remedy.

If you amend your agreement with the payer as a remedy to default, make sure you have an attorney document such changes. Should you be a senior lienholder, obtain the permission of the junior lienholders, if any, to protect your lien's seniority.

In general, four legal remedies are available to you if a creative solution to the default is not feasible:

- 1 Foreclose in court.
- 2 Foreclose out of court.
- 3 Sue on the note only.
- 4 Take the deed to the property.

All four options should be discussed with your attorney to determine which one is most appropriate for your situation. Not all options are available in all states. There are also federal laws that should be explored be-

fore making a decision. Only a competent real estate attorney is qualified to assess your situation.

Another remedy is simply to sell your delinquent note for cash. The market for such notes is limited, so be prepared to take a large discount.

Regardless of whether the payer is failing to make timely payments, failing to insure the property, failing to pay property taxes, or defaulting in any other way, it is always a good idea to contact an attorney.

For information regarding default on a junior lien, please refer to the section titled “Special Considerations” found on page 76.



Tips and Highlights

- The most common and obvious default is failure to make timely payments. Should a payment be late, the following steps are recommended:
 1. Check to see if a “grace” period exists. If so, honor it.
 2. If no grace period exists, or if it has expired, phone the owner and inquire about the payment.
 3. That same day, write a letter identifying the default, summarizing any action the owner has promised to perform. Mail this letter certified, return receipt requested.
 4. If the above steps do not remedy the situation, contact an attorney immediately.

- Declaring a deed of trust to be in default is a serious matter and should be handled by a competent real estate attorney who is familiar with the laws in the state where the property is located.
- Do not assume that foreclosure is imminent simply because you hired an attorney. Many payers will welcome an alternative to foreclosure, particularly if they have equity in the property.
- If you choose to amend your agreement with the payer as a remedy to default, make sure you have an attorney document such changes. Should you be a senior lienholder, obtain the permission of the junior lienholders, if any, to protect your lien's seniority.

Additional Provisions

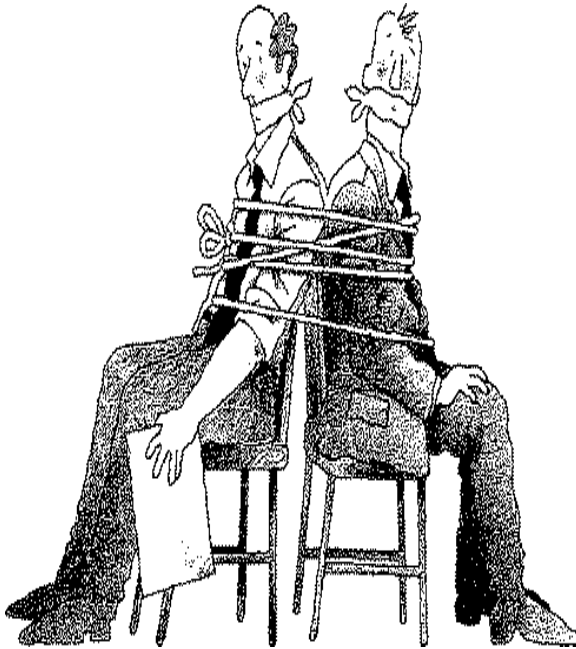
These provisions are found at the very end of the security instrument. It is here that you will add any additional clauses you wish to include. You can find a list of common clauses in the section titled "Special Clauses" which begins on page 100.

Signatures and Notary

Here you will see the signatures of the parties to the contract as well as the signature of a licensed notary. Sometimes the signatures of witnesses will be added to this section.

It is a good idea to have the names and mailing addresses of all parties typed here so they can be easily read and recorded.

Your Loan-to-Value Ratio (LTV) is the *total* current balances of all liens on a property divided by the current value of that property. The lower your LTV, the safer your investment.
What's your LTV?



4

Selling Property Via Owner Financing

In some parts of the country it is estimated that close to 50 percent of all households cannot qualify for conventional financing. Reasons are diverse, including being self-employed, being a nonresident alien, having multiple real estate loans, and being an investor whose main source of income is from rentals. Numerous property problems can also contribute to the need for owner financing. Examples of such problems are zoning is-

sues, access problems, and properties that are difficult to finance such as cabins, condominiums, and land.

Owner financing is often the solution to these problems. Owner financing is a wonderful way to 1) sell your property fast, 2) sell to a much larger market of purchasers, and 3) obtain top market value. In general, owner financing is becoming increasingly popular as conventional financing becomes increasingly restrictive, costly, and time-consuming.

If you plan on “carrying paper” in the future, you would be wise to structure your note so that it will demand top market value if the need to sell ever arises. *Most privately held liens will be sold sometime during their lifetime.* If the need to sell does not arise, you can rest assured that you have created a note that meets the top standards of this industry.

This chapter discusses key issues that affect the value of a lien. Please use the following information for educational purposes only. Capital Solutions recommends you always seek competent legal counsel whenever you create an owner-financed note.

Terms

The Purchase Price

Like other terms in the note structure, the purchase price is negotiable. Since you are providing the financing, you can and should demand top dollar for the property.

Establishing market value can be accomplished in a number of ways. One option is to order a professional

appraisal. A second option is to call a few real estate agents and ask them to provide a market analysis. These agents will find two or three comparable properties that have sold recently and base the market value of your property on their combined average sales prices.

Obtaining a market analysis from more than one agent is a good idea. Some agents will quote a high sales value simply because they want to be the listing agent on your property and they think that a high price is what you want to hear, even though it may not truly reflect current market value. Obtaining feedback from more than one agent can help eliminate this problem.

The Down Payment

Getting a substantial down payment is the number one thing you can do to minimize your risk when owner financing a property. This is your protective equity. Do not underestimate its importance. Should you need to foreclose, it is the main factor that will determine whether you can recover your investment without a loss. This is especially the case if you are holding a junior lien. See page 74 for more information on junior liens.

Most experts agree that the down payment should be at minimum 10 percent of the sales price. You want the purchaser to be monetarily committed to the property, particularly when times get rough. The greater the down payment, the more the purchaser has to lose should he or she default, and the greater chance you have of recovering your investment through foreclosure. However, it is our belief that an even greater benefit to a large down payment is the chance of finding a creative solution and avoiding foreclosure. In general, a property owner with a large amount of equity in the property is more motivated to work out a creative solution

with the lienholder, and therefore avoid a costly foreclosure, than is a property owner with little or no equity.

Payers who are not financially strong enough to make a 10-20 percent down payment may lack the resources needed to deal with problems that may arise. Common personal problems include divorce, death, loss of job, and temporary health problems. Expensive problems with the actual property may include maintenance, roofing problems, special municipal assessments, and natural disasters.

Foreclosures can be very expensive; therefore, many conventional lenders will not make loans for more than 80 percent of the value of the property. Sometimes even 20 percent equity is not enough for the lender to recover the amount owed should he or she foreclose. Since you are playing the role of the lender, you, too, would be wise to accept no less than a 20 percent down payment.

Due to the risk involved, down payments of less than 10 percent can severely decrease the amount an investor will pay for your note if sold soon after the lien was created. Heavily discounting the note is the only way the investor has to build back in the protective equity that would have been created through an adequate down payment. It is a general rule that the greater the down payment given at closing, the more your note will be worth.

Due to the popularity of the “no money down” seminars and books available, you may find that many prospective purchasers will attempt to put together a “no money down” deal. This means they will borrow the

down payment from a private person, usually a family member, or ask you to spread out the down payment over time. No-money-down transactions are highly risky and often are considered to be a “default waiting to happen.” Politely but firmly inquire where the down payment funds are coming from. Remember, you want to sell to someone who is truly committed to the property and, therefore, to paying you.

Balloons

Adding a balloon payment seven to ten years down the road can be a good idea. This means that the loan becomes due and payable at that time. Should the purchaser be unable to make the balloon payment, you can negotiate a higher monthly payment, an increased interest rate, and a new balloon date in exchange for not foreclosing. This can be a true “win-win” situation since you will have increased the market value of your note by restructuring it and the purchaser will have avoided a foreclosure.

In general, the sooner a balloon is due, the more a note is worth. However, balloons due within the first five years should be used with caution, for two reasons:

First, there may not be enough property appreciation to make refinancing possible, or the buyer may not improve financially and thus may not qualify for refinancing.

Some buyers will be so eager to purchase a property that they will agree to terms that may ultimately be a “lose-lose” situation for both parties. This can occur if you structured the balloon payment to come due right before you need the balloon payment money to pay a planned expense such as your child’s college tuition.

You could find yourself in a difficult situation if the balloon is not paid as agreed.

Second, the value of your note may decrease since some investors shy away from notes with balloons that are due within five years. The reason is that many balloons end up being rewritten when the payer is unable to refinance or come up with the funds for the final payment. Most investors who purchase notes will aggressively avoid foreclosure and will rewrite the loan rather than foreclose on a payer who defaults on the final balloon payment. *However, investors always prefer being paid off over restructuring the note.* Should the payer of your note fail to make the balloon payment, immediately seek competent legal counsel.

Amortization

Amortization is a method of equalizing monthly mortgage payments over the life of a loan. Payments usually are paid monthly but can be paid annually, quarterly, or on any other schedule. In the early part of a loan, repayment of interest is higher than that of principal. This relationship is reversed at the end of the loan. How quickly a loan amount is reduced depends on the interest rate and the size of the monthly payment. A small monthly payment and/or a high interest rate can lengthen the time it takes to pay off the loan.

As a note owner, your goal is to keep the length of the lien as short as possible, so that you receive money faster. To shorten a note, you will need to increase the monthly payment, decrease the amount financed by increasing the down payment, or decrease the interest rate.

Loans that run ten and twenty years are preferable to loans that run thirty years. In other words, you will get more money for a 15-year lien than you would for a 30-year lien.

The Interest Rate

The interest rate you charge should be higher than interest rates found on a conventional loan. Most states have usury laws, so you want to make sure you do not violate the legal maximum. Alternately, you do not want to charge too little interest. From a legal standpoint, charging no interest is acceptable. However, from an income tax standpoint, it is not. In fact, the IRS will impute or “put in place” interest if a minimum interest rate is not charged. Such imputed interest rules fall under IRS Code Section 483 and §1271 through §1274.

The Monthly Payment

Both the interest rate and length of the loan will influence the monthly payment. A general rule to follow is to make the monthly payment no less than 1 percent of the principal balance owed at the beginning of the loan. Thus, a loan with a starting balance of \$60,000 should have a monthly payment of \$600 (principal and interest) plus any taxes and insurance.

For first-time home buyers or those with low income, you may want to start out by asking them what they could comfortably pay each month. That way you can structure the interest rate and length of the lien around this figure.

You do not want the owner to have to struggle each month to make the payment. This is not a true win-win situation, and it could set both of you up for failure. If

you would like assistance in determining the length of a loan, call Capital Solutions at 1-888-372-9993. We will be happy to fax or mail you a complimentary amortization schedule.

Late Charges

Imposing a late charge to encourage prompt payment is often a good idea. Some states require a grace period for certain types of property. Check your state laws by calling a real estate attorney.



Tips and Highlights

- Obtaining a market analysis from more than one agent is a good idea.
- Getting a substantial down payment is the number one thing you can do to minimize your risk. Capital Solutions recommends a down payment of 20 percent.
- The greater the down payment given at closing, the more your note will be worth.
- Adding a balloon payment seven to ten years down the road can be a good idea. It may also increase the value of your note.
- In general, the sooner a balloon is due, the more a note is worth. However, balloons due within the first five years should be used with caution, for two reasons:
 1. Some buyers will be so eager to purchase a property that they will agree to terms that may ultimately be a “lose-lose” situation for both parties.

2. The value of your note may decrease since some investors shy away from notes with balloons that are due within five years.
 - Should the payer of your note fail to make the balloon payment, seek competent legal counsel immediately.
 - Short-term loans are more valuable than long-term loans. You will get more money for a 15-year lien than you would for a 30-year lien.
 - The interest rate you charge should be higher than interest rates found on a conventional loan.
 - When structuring the terms of your note, a general rule to follow is to make the monthly payment no less than 1 percent of the principal balance owed at the beginning of the loan.
 - For first-time home buyers or those with low income, you may want to start out by asking them what they could comfortably pay each month.
 - Imposing a late charge to encourage prompt payment is often a good idea.

Taxes and Insurance

Most notes that we at Capital Solutions review require the property owner to pay taxes and insurance. Unfortunately, we also find that property owners are delinquent in making these payments and that the lienholders are unaware of this because they have not taken the time to call the tax office once a year.

A popular solution to this problem is to pay the taxes and insurance yourself. Lending institutions require buyers to pay one-twelfth of the annual property taxes and insurance with each monthly payment, and we suggest that you do the same. At the end of the year, money will be available for you to pay these bills. If you choose this route, remember to include a clause in your note that provides for increasing or decreasing the payment as the cost of taxes and insurance increases or decreases. For a thorough review of the two most common methods of handling taxes and insurance, please refer to the section titled “Tax and Insurance,” beginning on page 34.

A Word on Tax Liens

With few exceptions, recorded liens are “technically” wiped off a property when both of the following have occurred: 1) the property tax foreclosure period has expired without taxes being brought current, and 2) the municipal or county treasury has exercised the right to place a clerk’s deed on the property.

Most treasuries take the position that they then own the property and can sell it at a tax auction or can sell the tax lien to an investor. Note: This issue remains vague and has been debated in state courts. The question being debated is whether a clerk’s deed is a complete deed, since it is essentially the forced sale of a property.

According to the Anchorage, Alaska tax office, this means that your owner-financed lien is wiped out and you have no legal interest in the collateral unless the property owner “purchases back” the property from the municipality. Lienholders faced with this situation should hire a competent attorney immediately to argue that they do still have an interest in the property. They

can hopefully then bring the tax account current and reinstate their lien and/or foreclose on the payer. *This is assuming the property has not yet been sold at auction and/or the tax certificate has not been sold to a third-party investor.*

Each municipality will handle tax foreclosures differently. Understand how the tax office that services the property used as collateral on your note operates. Even more important, keep them informed of any change to your address. This is because the tax office usually will attempt to inform you through the mail, of any pending clerk's deed or other similar action.

However, you should never assume the tax office will contact you when a problem arises. Once a year you should call the tax office and determine whether taxes are current. Not making that one phone call a year could cost you your investment, not to mention the emotional expense of dealing with a messy situation. Some tax offices are now "on-line" and you can check tax payment status by dialing into the tax office via computer modem. The "Tax ID" of the property in question is used to access the tax payment records of that property.

Since tax offices may or may not notify lenders of tax problems, traditional lenders combine tax and insurance costs into each monthly payment. Additionally, they hire a company to check that taxes are actually paid. As a private lienholder, you too should take extra precautions to ensure property taxes are paid.

First American Tax Service is a firm that will do this for a onetime fee, good for the life of the lien or as long as you own the lien. In other words, if you subscribe to First American's tax service and you later sell your lien

to a third party, that third party would have to set up a new contract with First American. (This onetime fee is around \$60.00.) You can contact First American Tax Service at the following number: 1-800-229-8291. You may also find it valuable to check out their web site since it contains a comprehensive underwriting library for all fifty states. Their Internet address can be found at: “<http://www.firstam.com>”.

A Word on Hazard Insurance

You should verify that the property’s hazard policy in place is issued for an amount no less than the amount owed to you. The property owner should want the property insured for its full value, and you can require this within the security agreement (usually within the insurance section though possibly as a separate clause).

Confirm that you are listed as the “mortgagee/grantee,” “beneficiary” or “first contract holder” on the insurance policy. You are thus entitled to the proceeds from any insurance claim ahead of the property owner.

If you are not listed as the beneficiary to the insurance policy, you have no security. If the house or structure burns down, you get exactly nothing!

If you are a junior lienholder, making sure that adequate insurance covers the entire debt owed is of great importance. The entire debt owed is the amount owed to you plus the principal owed on any other liens. Since you are not in senior position, insurance benefit monies will be paid first to the senior lienholders, then to junior lienholders. In other words, someone else will be paid off first, and you need to make sure there is adequate coverage to pay the amount owed to you.

You should also make sure you receive annual renewal notices from the insurance company and then file them for record keeping purposes. If you do not have a recent renewal notice, call the insurance company and obtain one. In addition, if your mailing address ever changes, call the insurance company and have them update their records, just as you would with the tax office. Be aware that most companies who service loans will not hold proof of insurance in their file. If one is sent to them instead of to you, they probably will send it back to the insurance policy provider. Refer to the section titled To Use or Not to Use a Servicing Company beginning on page 93 for information regarding servicing companies.

The insurance company should issue you a *Notice of Cancellation* if the owner fails to keep the policy current. Should you receive such a cancellation notice, immediately call the owner regarding this possible breach of contract. To be safe, add the property to your own insurance policy until you have confirmation that insurance has been reinstated at the correct amount and you are again listed as the beneficiary.



Tips and Highlights

- Each municipality will handle tax foreclosures differently. Understand how your tax office operates, (i.e. the tax office which services the property used as collateral on your note).
- Once a year you should call the tax office and determine whether taxes are current.
- The following checklist will help you keep track of tax and insurance:

- Annually check that property taxes are paid.
- Check that the municipal tax department has your correct mailing address, that they have you listed as a lienholder on the property, and that the property owners are who you think they should be. *This is a way of double checking that the property has not been resold without your knowledge.*
- Annually check that the hazard insurance policy on the subject property is in effect, and that the property owner is who you think they should be. Again, this is a way of double checking that the property has not been resold without your knowledge.
- Make sure you have a copy of the insurance binder (proof of insurance) showing that you are listed as beneficiary of the insurance policy. File this insurance binder for future reference.
- Check that the hazard insurance policy is written for an amount no less than the amount owed to you, or for the value of the property if you required this within your contract.
- If you are a junior lienholder, make sure adequate insurance covers the entire debt owed; *not just what is owed to you.*
- Have you moved? Call both the tax office and the insurance company and supply them with your new mailing address.
- Have you received a Notice of Cancellation? Insure the subject property yourself until you

receive confirmation that insurance has been reinstated.

Purchaser's Credit Worthiness

The value of your note also depends on the credit of the buyer. Selling to someone with poor credit will decrease the value of your note substantially. Try to avoid this situation up front by obtaining written authorization to pull credit on the prospective buyer and review two individual credit reports from different reporting agencies. The reason you may want to review two credit reports is that sometimes different agencies pull up different information on the same prospect. Consider that banks and conventional lenders utilize what is called a “tri-merge” credit report. Tri-merge reports contain credit information taken from three individual credit reporting agencies. This data is merged into one, often lengthy, master report which is then reviewed by the lender. Utilizing tri-merge reports is standard practice in the lending industry. Since you are also a lender, you should not hesitate to shadow the business practices of these firms.

Also, check employment information, annual income, debts owing, and personal references. Should the buyer have damaged credit, you may want to insist on a larger down payment, additional collateral, and/or a cosigner. Like all of us, buyers tend to be creatures of habit. Even though they may have the best of intentions, they will most likely do to you what they have done to their previous lienholders.

Note: Cosignatures are somewhat worthless unless the cosigner pledges specific assets to you. This can best

be accomplished by using a separate deed of trust signed by the cosigner.

A Word on Credit Reports

When dealing with credit reports, look for patterns of nonpayment rather than a single report of nonpayment. The reason behind this suggestion is that people are generally creatures of habit. You should determine, therefore, if the blemishes on the credit report (if any) indicate a tendency to not pay financial obligations in general, or if they represent an isolated, specific instance with a feasible excuse behind it. You will also need to determine what type of blemishes you are willing to overlook, as well as how many. For example, some lenders will overlook all unpaid medical bills.

However, some blemishes should never be overlooked. Some obligations can turn into liens and be placed against the payer as well as the property. If this occurs, the position of your lien may be compromised. Common examples of such blemishes would include child support obligations and IRS obligations. Please refer to the section titled “Preliminary Title Report” beginning on page 70 for more information on how to protect yourself.

One significant blemish that may appear on a credit report is a past bankruptcy. Should this appear in a prospective purchaser’s credit history, you should ask yourself the following questions:

- Has the bankruptcy been discharged?
- Has credit been reestablished?
- Do new accounts show a positive payment history?

You are trying to determine if the prospect is currently paying his or her bills and if he or she will continue to do so in the future. The more questions answered negatively, the greater the risk that the prospect will fall back into a previous pattern of poor credit. Be aware that it is not uncommon for a person with a bankruptcy to re-establish credit for a number of years, then slowly slide back into a pattern of making late or no payments.

If the prospect has been a homeowner in the past, look closely at the payment history on that lien. If the payment history is good on that lien but other obligations remained unpaid, you know that the prospect made the home mortgage a priority over other debts. Take this into consideration. If the prospect made late payments on a past mortgage, the chance is good that he or she will make late payments on your lien. Remember, the later the payment, the more difficult it may be for the payer to bring the account current.

Ultimately, you are playing the role of a bank and the degree to which you investigate the prospect is a personal business decision. Should the prospect be motivated, he or she most likely will provide whatever documents you request. As a general rule of thumb, the poorer the credit and lower the income, the more down payment you should demand as compensation for your increased risk.



Tips and Highlights

- Selling to someone with poor credit will decrease the value of your note substantially.
- When reviewing a credit report, determine if the blemishes (if any) indicate a tendency to not pay

financial obligations in general, or if they represent an isolated, specific instance with a feasible excuse behind it.

- Some credit blemishes should not be overlooked since they could turn into liens against the payer and the property.
- Should a bankruptcy appear in a prospective purchaser's credit history, you should ask yourself the following questions:
 - Has the bankruptcy been discharged?
 - Has the prospect reestablished credit?
 - Do new accounts show a positive payment history?
- It is not uncommon for a person with a bankruptcy to reestablish credit for a number of years, then slowly slide back into a pattern of making late or no payments.
- As a general rule of thumb, the poorer the credit and lower the income, the more down payment you should demand as compensation for your increased risk.

Preliminary Title Report

A Preliminary Title Report, also called Commitment to Insure, is a document that identifies liens, liabilities, and conveyances that affect title to a specific piece of land. You should obtain a Preliminary Title Report or a Commitment to Insure on any property that will be used to secure your note. *Use only a reputable title company.*

Should the Preliminary Title Report reveal no clouds or flaws to the title, you should then purchase a title insurance policy. Two types of policies are available: an owner's and a lender's policy. Owner's policies are the most common policies requested, usually being issued to the purchaser of the property. *However, the type of policy you should purchase is a lender's policy.*

Owner's policies only insure clear title from the seller to the purchaser. In other words, they *check the background of the seller* to make sure no liens cloud the title. However, when issuing a lender's policy, the title company *will check into the background of the purchaser*. Any encumbrances against the purchaser, such as mechanics' liens, governmental liens, and child support liens will show up in the report. A lien against the purchaser, such as a child support lien, can be levied against the property itself. If this occurred, your owner-financed lien could become subordinate to the child support lien. In other words, you may find yourself to be in second position, not first position.

Assume for a moment that you sold a property to someone who had a child support lien against him or her for failing to pay child support, but you did not know about this lien because you did not purchase a Preliminary Title Report that researched the purchaser. That child support lien could be attached to the property, making your lien subordinate to it. If this occurred and the payer went into default, you would not be able to foreclose and regain title to the property until that lien was paid in full. You would have to pay that child support lien yourself in order to regain title to the property, adding considerable cost to the foreclosure. In addition, you would not be able to sell your note for cash until the child support lien was paid and all clouds on the title

cleared. This could cause great distress if you needed immediate cash. For these reasons, Capital Solutions highly recommends purchasing a lender's title insurance policy.

Please note the following:

1. Some insurers will put an escape clause into their policies. Make sure you read and understand the policy carefully, paying close attention to the exceptions.
2. The title policy the buyer of the property orders for his or her own use may be different from your policy, depending on your state law. Some states combine policies into a joint protection policy; others issue separate policies. If you are unsure about your state law, call a local title company and inquire. Do not assume your lien position is insured just because you know the purchaser purchased a policy for his or her use.
3. All liens are subordinate to governmental liens. Examples would include property tax liens, IRS liens, and child support liens. Even mechanics liens (property improvement liens) are superior if the work was started before the deed of trust was recorded.
4. Institutional lenders require the issuance of a lender's title insurance policy when they make a loan. They do not settle for an owner's policy. Since you are also playing the role of a lender, it would be wise for you to also purchase this type of insurance.

In summary, since governmental liens have precedence over other lien(s) that may be issued against a property, always order a lender's title insurance policy. If the policy reveals flaws to title or the purchaser, delay closing until the flaws are cleared.

Closing Agencies

Problems can occur if you do not close your transaction through a reputable closing agency, such as the title company that issued the Preliminary Title Report. One such problem is if the purchaser obtains another lien and records it before your lien. It is not uncommon for purchasers to take out a second mortgage to pay closing costs and any required down payment. In this scenario, you would be a junior lienholder, not a senior lienholder, and this would increase your risk considerably. Reputable closing companies will often check and double check title before they close a transaction to make sure no new liens were quietly recorded against the property. Some agencies also will recheck after closing to make sure the loan(s) was recorded in the appropriate order.



Tips and Highlights

- Lender title policies insure that title to the property is good, as well as insure the purchaser is free from governmental liens at the time the policy is issued.
- Some states combine policies into a joint protection policy; others issue separate policies. Do not assume your lien position is insured just because you know the buyer purchased a policy for his or her use. Call the title insurance company that issued the policy to find out.

- If the Preliminary Title Report reveals flaws to the title or purchaser, it would be appropriate to delay closing until these flaws are cleared.
- Institutional lenders require the issuance of a lender's title insurance policy when they make a loan. They do not settle for an owner's policy. Since you are also playing the role of a lender, it would be wise for you to purchase this type of insurance also.

If the Payer Is Not an Individual Person

Should the payer be a trust, partnership, or corporation, seek legal advice before closing. Additional safeguards may be needed to protect you. In general, selling to an entity other than someone who will have personal liability for the repayment of the debt can decrease the value of your note. This is because no individual person can be sued for debt repayment, nor can wages be garnished.

Junior Liens

If you are thinking about creating a junior lien, you need to review some important considerations. Most important, know that junior liens carry more risk than senior liens and hence are generally worth less than senior liens. This is because the lien in first position has legal rights that are greater than junior liens. Should the first position lien go into default and foreclosure occur, all junior liens are eliminated and those lienholders are left with unsecured debt. This is similar to the scenario you are faced with if the property used as collateral for your lien goes into tax foreclosure. (Even though you may be in first position, your lien may be wiped out by the tax lien that is placed on the property. For more

information regarding taxes, please refer to the section titled “A Word on Tax Liens” found on page 62.)

Junior lienholders have a couple of options to prevent their liens from being eliminated if senior lienholders foreclose:

1. Pay the obligations of all senior liens, bringing the loan(s) current. Continue to pay these obligations while initiating foreclosure on the junior lien. This is the most commonly used option, but is only an option if the senior position lien does not prohibit assumption.
2. Eliminate all senior liens by paying the loans off.
3. Purchase the lien being foreclosed upon.

Foreclosure

Foreclosure can be very expensive. Most lienholders, particularly junior lienholders, underestimate the true costs of foreclosure. Try not to view foreclosure as an advantage of owning a deed of trust, but rather as a last resort in recovering your investment.

Assume for a moment that you are a junior lienholder and that the senior lienholder foreclosed on the payer. At the foreclosure sale you end up purchasing the property. As a junior lienholder, you will have to continue to make the monthly payments on any senior liens until you resell the property. That is, unless you have the funds available to pay off the senior lienholder. In addition to these costs, you will incur many of the following: real estate commission fees, attorney fees, repair and cleanup costs, possible tax lien payoffs, title and escrow fees, as well as other miscellaneous costs in-

volved with the resale of a property. In general, foreclosure is costly, and it can be difficult to recover one's investment unless the payer had a lot of protective equity in the property before the foreclosure took place.

Special Considerations

You should understand all the terms and conditions of any lien that is senior to your note. Following are a few special considerations you should review before creating a junior lien. Use the following list as a starting point only. Your attorney should be able to identify additional considerations unique to your situation.

- Balloon payments
- Prohibition against junior liens
- Prohibition against assumption
- Loan status report on the senior lien
- Notice to the grantor
- Negative amortization
- Due-on-sale clause
- Future advances
- Release clause
- Prepayment penalty
- Senior lien payment terms

Balloon payments. If you own a junior lien that has a final balloon payment, and a senior lien also has a balloon payment, the due date on any senior lien should be at least 18 to 24 months beyond the due date on your junior lien. In other words, you want your junior lien to be paid off before the balloon payment of any senior lien is due.

Prohibition against junior liens. Some senior liens prohibit junior liens from existing. It is never advisable to create a junior lien behind a senior lien that prohibits

junior liens. If you decide to create a junior lien behind a senior lien that prohibits junior liens, make sure you get written authorization from the senior lienholder or risk dealing with possible negative consequences.

Prohibition against assumption. The senior lien may also prohibit assumption. This means that you are prohibited from making the monthly payments on the first position lien while you initiate foreclosure. Such a prohibition may surface in the form of a due-on-sale clause. Since you are not allowed to take over payments, you will need to pay off the entire senior lien or purchase the lien from the lienholder.

Loan status report on the senior lien. You should always obtain a loan status report for any senior lien to be sure it is current. Keeping track of payments made on senior liens can be difficult. One way of protecting yourself is to require the purchaser send you cancelled receipts of monthly payments made on all senior liens, or receipts of payments made. Place this requirement into your contract with the purchaser. Failure to supply you with such proof of payment may then be considered evidence of default.

Notice to the grantor. Should default occur, you may need to serve notice to the grantor. Serving this notice may be difficult if the grantor's address is unknown. It is thus a good idea to require the grantor designate a local agent for such service. Identify this local agent within your note and deed of trust, clarifying that this agent has the authority and power to act as the legal agent for you, the grantee. Remember to seek legal counsel when drafting real estate documents.

Negative amortization. If the senior lien has an adjustable payment amount, the loan could negatively amortize. This means that the interest payment is greater than the total payment, thus the interest not covered by the total payment is added to the loan balance, causing the principal balance to increase. Remember, this senior lien is the obligation you will be paying if you foreclose on your junior lien. Negative amortization can quickly decrease the protective equity you have as a junior lienholder.

Due-on-sale clause. You also want to look at due-on-sale clauses. If the senior lien has a due-on-sale clause and you are forced to foreclose, the senior lienholder can call the loan due and payable in full. This is because after foreclosure the former property owner has alienated, or gone out of title. You should therefore try to get the senior lienholder to sign a non-acceleration letter to prevent this from happening. It is your best protection because it protects you in obtaining the property through foreclosure if you keep the senior position lien(s) current. If you resell, the senior lienholder still has the right to accelerate his or her loan unless he or she approves the new buyer. This non-acceleration letter buys you time to resell the property and allows the senior lienholder to avoid foreclosure. It therefore creates a win-win situation for you both. If you cannot obtain a non-acceleration letter make sure you have the capability of paying the senior lien in full.

Future advances. Senior liens that contain a “future advances” clause should be approached with great caution. This clause allows the lender to advance more money to the purchaser. If this occurs, your junior lien could be positioned behind a much larger amount of debt than previously thought, thus increasing your risk.

Release clause. Release clauses present another risk to junior lienholders. A release clause allows the property owner to release or unencumber part of his or her property. This is common with land developers who need such releases so they can build and sell from portions of the property. Senior lienholders normally do not need the authorization of junior lienholders to release part of the property used as collateral on their lien. This means that your note may not be adequately secured. Even worse, because your consent usually is not needed for the release, you may not know that your note is under-collateralized until you need to sell your note or foreclose on the payer.

Prepayment penalty. A prepayment penalty clause in the senior lien will hinder the chances that the senior lien will be paid off early, thus also decreasing the chance that your junior lien is prepaid. This clause can decrease the value of your junior lien considerably.

Senior lien payment terms. If the senior lien has unusual payment terms, such as a high interest rate or sporadic lump sum payments, the value of subordinate liens can suffer. If the property owner wanted to sell, it would be difficult to find a buyer who was willing to assume a lien with such unusual terms. Since the value of real estate is tied to its available financing, a property with unusual terms will be more difficult to sell. Consequently, all liens junior to the unusual lien will suffer in value.

Market Value of a Junior Lien

If you own a junior lien, you should understand some basic principles regarding its market value. Determining the value of a junior lien involves comparing the size of the junior lien to that of any and all senior liens.

The larger the junior lien is in comparison to any senior liens, the less risk there is to the note owner and hence the more that note is worth. Small junior liens behind large senior liens are heavily discounted, and investors who purchase them will often walk away if the payer defaults. In other words, investors will not even bother trying to foreclose; the cost is too great. Therefore, if you are going to create a junior lien, try to make it as large as you can and/or secure additional collateral for the lien.

One way of accomplishing this would be to ask the property purchaser to obtain a small mortgage from a traditional lender. Offer to owner finance the larger, remaining balance so that your junior lien is larger than the traditional lender's senior lien. Your junior lien will then be marketable due to its large size in comparison to the senior lien and can be sold for a decent price if the need ever arises. Should you ever need to foreclose, there are other benefits. The cost to foreclose will be less since the senior lien is smaller than your junior lien. A smaller senior lien means a smaller obligation (usually monthly), which you will be paying during the time it takes to foreclose and resell the property. In effect, it means the chances of your recovering your investment are greater.

Remember that the owner's equity in the property is your greatest protection. If the owner has little or no equity, and you hold a junior lien and have to foreclose, you may be lucky to recover any money after paying foreclosure costs, real estate commissions, possible back taxes, money spent fixing up the property, and the obligations of the senior lien(s) during the foreclosure period.

If you owner finance a small junior lien, try to make it no less than 50 percent of all senior liens combined. A junior lien that is less than 50 percent of the senior liens will be discounted greatly. Let's look at an example.

For the purpose of this example, assume the following:

- You are selling a multifamily, 12-unit apartment complex.
- You have owned it for many years and own it free and clear with the exception of a small \$75,000 lien.
- This \$75,000 loan is assumable by a qualified purchaser.
- You are selling the building for \$300,000.
- Your equity in the property is thus \$225,000.
- The buyer is going to pay 10 percent or \$30,000 as a down payment.
- The buyer can qualify at a local bank for a loan in the amount of \$220,000.
- You have been asked to owner finance the remaining debt of \$50,000.

Here's what the buyer proposes:

| | |
|-------------------------|-----------|
| Sales Price | \$300,000 |
| Down Payment | \$ 30,000 |
| 1st Lien From Bank | \$220,000 |
| 2nd Owner-Financed Lien | \$ 50,000 |

In this scenario, your owner financed junior lien of \$50,000 would equal 23 percent of the senior lien (\$50,000 divided by \$220,000). This is less than the recommended 50 percent. If you ever wanted to sell your junior lien, it would be discounted heavily because the senior lien is so large. If you ever chose to foreclose, you would have to pay the monthly payments of the senior lien. In some states the foreclosure process can be very slow and hence very expensive. Overall, this scenario is risky for you because you are being asked to create a junior lien that is positioned behind a large senior lien. Due to this risk, the junior lien you are being asked to create is virtually worthless if you ever needed to sell it for cash.

A better way to structure the deal would be to ask the buyer to assume the \$75,000 first-position loan that is currently on the property. Ask the buyer to obtain a second position mortgage in the amount of \$95,000 and offer to owner finance the remaining \$100,000. This scenario is summarized as follows:

| | |
|---------------------------|-----------|
| Sales Price | \$300,000 |
| Down Payment | \$ 30,000 |
| Assume Existing 1st Lien | \$ 75,000 |
| Obtain 2nd Lien From Bank | \$ 95,000 |
| Owner Finance 3rd Lien | \$100,000 |

Even though this scenario places you in third position, behind the existing first and the new second, you have created a note that is much more valuable. Remember, the value of a junior lien involves comparing the size of that junior lien to the senior liens. In this example, your third-position note in the amount of \$100,000, is positioned behind a combined total debt of \$170,000 (\$75,000 first-position lien and the new \$95,000 lien).

It is thus 59 percent of the first and second liens combined (\$100,000 divided by \$170,000). As mentioned previously, if you hold a junior lien you should try to make it no less than 50 percent of all senior liens combined. Therefore, this third-position lien has much more value than the second-position lien the property purchaser originally proposed. Thus, if you needed to sell all or part of your third-position lien for cash today, you could do so without a heavy discount. Additionally, it means that if you needed to foreclose, you could do so less expensively and therefore have a greater chance of recovering your investment.



Tips and Highlights

- Junior liens are more risky than senior liens and hence are generally worth less than senior liens.
- Foreclosures can be very expensive. You will need to pay the obligations of all senior liens in order to protect your interest while you initiate foreclosure, unless you have the funds to pay off the senior liens.
- Remember that the owner's equity in the property is your greatest protection.
- The larger the junior lien is in comparison to any senior liens, the less risk there is to the note owner and hence the more the note is worth.
- Try to make your junior lien no less than 50 percent of all senior liens combined. A junior lien that is less than 50 percent of all senior liens will be discounted greatly.
- It is never advisable to create a junior lien behind a senior lien that prohibits junior liens.

- You want your junior lien to be paid off before the balloon payment of any senior lien is due.
- You should obtain a loan status report for any senior lien to be sure it is current. Keeping track of payments made on senior liens can be difficult. One way of protecting yourself is to require the purchaser send you cancelled receipts of monthly payments made on all senior liens, or receipts of payments made. Place this requirement into your contract with the purchaser. Failure to supply you with such proof of payment may be considered evidence of default.
- Servicing notice of default to the grantor may be difficult if the grantor's address is unknown. You may require the grantor designate a local agent for such service.
- Negative amortization can quickly decrease the protective equity you have as a junior lienholder.
- If the senior lien has a due-on-sale clause and you are forced to foreclose, the senior lienholder can call the loan due and payable in full. You should therefore try to get any senior lienholder to sign a non-acceleration letter to prevent this from happening.
- Be wary of senior liens that contain a "future advances" clause.
- Release clauses present another risk to junior lienholders. A release clause allows the property owner to release or unencumber part of his or her property. This means that your note may not be adequately secured.

- Senior liens with prepayment penalties and senior liens with unusual terms are variables that will negatively affect junior liens.

Right to Sue

Clarify the right to sue by adding an addendum or extra paragraph to your contract stating that you reserve the right to personally sue the purchaser(s) should default occur. For more information on special clauses refer to the section titled “Special Clauses” beginning on page 100.

Understand Foreclosure Law

Ideally, you should fully understand foreclosure laws in your state and be prepared to consult with a competent attorney if the need arises. States differ in the average amount of time it takes for a foreclosure to conclude; thus the potential costs of foreclosure can differ dramatically from state to state. Understanding the foreclosure laws in your state will help you budget adequate cash reserves. This is particularly important if you are a junior lienholder.

Underlying Debt

You may choose not to pay off the amount you owe on your property at the time you sell. This is called underlying debt, often referred to as a “wrap.” In this scenario, the money you pay on your underlying financing is superior to the money owed to you by the new sale. This is because the underlying financing was put into place before the financing from the new sale. Please

refer to pages 22 and 23 for further information regarding how junior and senior liens are defined.

Check the documents on your underlying financing to make sure there is no due-on-sale clause requiring you to pay off the debt when you sell the property. If you choose to keep the underlying financing in place, make sure the new, inferior financing's monthly payment is at least 25 percent greater than the payment you will continue to make. This gives you a little breathing space.

For example, let's assume you are selling your home for \$100,000. You currently owe a balance of 50,000 to a local lender, with a monthly payment of \$700. You decide to sell the property, but the buyer cannot easily qualify for a loan because he or she is self-employed. You determine that owner financing will provide a reasonable solution so you structure the transaction as follows:

| | |
|---------------------|-----------|
| Sales Price | \$100,000 |
| Down Payment | \$ 20,000 |
| Owner-Financed Lien | \$ 80,000 |

Because you kept your existing financing in place, part of the monthly payment you receive from the self-employed payer goes to pay the monthly obligation you owe on the \$50,000 underlying lien. Since you owe \$700 a month, you know that you need to receive at least 25 percent or \$175 more per month from the self-employed payer. You thus structure your owner-financed note over a 14-year term, which at a 10 percent interest rate makes the monthly payment exactly \$886.56 per month. You will thus receive \$886.56 per month from the property buyer, and, out of that, you

will pay \$700 to the lender you owe. In this example, the \$50,000 lien you are paying is the senior lien since it was recorded before the new \$80,000 lien you owner-financed.

Another tip when structuring a wrap is to pay close attention to the payment or amortization schedule of the overlying financing in comparison to that of the underlying financing. If the underlying financing is paid off at a slower rate than the overlying lien is paid off, the “cushion” or difference between the two liens will shrink over time. In other words, the balance on the overlying lien will decrease faster than the balance on the underlying, causing your protective cushion to decrease. This cushion is part of your protective equity. As your protective equity decreases, the risk to you increases. (The other part of your protective equity comes from the down payment of the new sale. For more information, please refer to the section titled “Down Payment” on pages 44 and 55.)

To avoid this situation from occurring, you will need to review some amortization schedules. Most personal finance software such as Quicken allow you to generate and print amortization schedules. Compare the underlying financing schedule to sample schedules of your proposed overlying lien. Determine what your protective equity would be at the beginning of each repayment schedule, then compare that to a future date in time. Determine if your protective equity would shrink, remain the same, or increase over time. You can then finalize the structure of the overlying lien based on your findings.

Your goal when structuring a “wrap” should be to have your protective equity increase over the term or length

of the lien. To accomplish this you need to make sure that the balance on the underlying lien will be paid off more quickly than that of the overlying lien.

There are two common methods used to accomplishing this goal. The first method involves making the interest rate on the overlying lien higher than that of the underlying lien. A higher interest rate on the overlying lien means that the balance will decrease more slowly than if it had a lower interest rate. (Assuming other lien variables are identical.) Thus the underlying lien, having a lower interest rate, will be paid down more rapidly. This concept can be difficult to understand. It may be helpful to review the section titled “Annual Interest Rate” beginning on page 32 as well as the section titled “Amortization” found on page 58.

A second and highly recommended method is to instruct the servicing company to apply the *entire monthly payment received* from the overlying lien directly to the underlying lien. This means that you will not receive the spread between the payment on the overlying and the payment on the underlying. (As mentioned previously, this spread should be at least 25 percent.) Obviously, this option should not be considered if you need this monthly cash flow for personal living expenses or other allocations.

Use of this technique will rapidly decrease the balance of the underlying lien, thereby increasing your protective equity. *Caution: Make sure the servicing company understands that this additional amount is to be applied directly to the principal balance of your underlying lien.* Some servicing companies will apply extra payment amounts to an unlimited number of future payments. In other words they will not apply it to the prin-

capital balance. If you are unsure how extra payment amounts are applied, call your lender or servicing company and inquire.

Other Tips to Protect Yourself

As a property seller, there are a couple things you should do to protect yourself when selling via a wrap. First, do not attempt to service the wrap on your own. Always use an independent third party servicing company. This not only protect you, it protects the property purchaser and is thus worthwhile to both parties.

Second, make sure the servicing company is given detailed instructions and that they will send you prompt notice if the purchaser makes a late payment. You can thus step in and make payments on the underlying lien yourself while you attempt to resolve the situation. Likewise, it is common for the property purchaser to ask for a similar provision, in case you fail to make the payment on the underlying. If you will be prepaying the underlying, make sure the lender understand how prepayments are to be applied. You should review the section titled “Junior Liens,” beginning on page 74 as well as “To Use or Not to Use a Servicing Company” on page 93. It is important that you understand the risks involved with junior liens and that you do not assume the servicing company will automatically perform certain duties.

Third, seek the counsel of an experienced real estate attorney who can put special language into your security instrument. You may want to review the list of special clauses beginning on page 100 and if appropriate, ask that these be included within your security instrument.

Selling a Wrap

Given the previous example, if you ever sold your \$80,000 lien you may be required to pay off the senior \$50,000 lien out of the proceeds of the sale. This would consequently move your \$80,000 junior lien up one position into a senior position. If you sell your note and choose to keep the underlying financing in place, your note will be purchased as a second position lien. This means that you will most likely receive less money for your lien than you would if you paid off the underlying at closing. In most cases, but not all, it is to your advantage to have the underlying paid off at closing.

It is not uncommon for lienholders to become disillusioned with the way they structured their wrap once they realize that their equity, or the difference between what they owe on the underlying and what is owed to them on the overlying, has decreased over time. You can avoid this potential problem by using the previous suggestions. However, an even greater benefit to structuring a wrap so that the underlying lien is paid off rapidly becomes apparent if you need to sell your note for cash. With a smaller underlying, you will walk away from closing with more money. In addition, since you have increased your protective equity, any discount incurred from selling your note will be softened. Your equity increase can minimize, often dramatically, any discount. Remember, even if you never intend to sell your lien, it is wise to structure your lien so that it will bring top market value should an emergency occur. For further information regarding the sale of owner financed liens, please refer to the section titled “Selling All or Part of your Note for Cash” beginning on page 113.



Tips and Highlights

- If you choose to keep the underlying financing in place, make sure the new, inferior financing payment is at least 25 percent greater than the payment you will continue to make.
- Pay close attention to the payment or amortization schedule of the overlying financing in comparison to that of the underlying financing. You may find this difference to be decreasing. This can be prevented by carefully structuring the overlying financing as well as making prepayments to the underlying financing.
- If making prepayments, make sure the servicing company understands that this additional amount is to be applied directly to the principal balance of your underlying lien.
- Do not attempt to service the wrap on your own.
- Make sure the servicing company is given detailed instructions and that they will send you prompt notice if the purchaser makes a late payment.
- Always seek the counsel of a competent real estate attorney.
- Your equity increase can minimize, often dramatically, any discount resulting from the sale of a wrapped lien.

Know Whether to File 1098 & 1099 Forms

You may be required to file Internal Revenue Code forms 1098 and 1099 if the IRS thinks you are in the lending business. Always consult with an accountant

if you have any questions regarding your tax responsibilities.

You are required to report annually on form 1099 interest you pay in the course of your investments or trades or business activities, which includes property rentals. If payments are made to an individual, partnership, or unincorporated business, and these payments exceed a certain amount annually, you are required to report.

You are required to file form 1098 if you or your company, corporation, partnership, or trust are in a trade or business and you receive mortgage interest from an individual during the course of your trade or business, and that interest exceeds \$600 in a calendar year. You must provide Form 1098 to each individual who paid you at least \$600 of mortgage interest in the last year. You also must send the IRS a copy of this form. If you or your entity are not in a trade or business or your receipt of mortgage interest is not related to your trade or business, you do not have to send in Form 1098 to the IRS or to your borrowers.

You may be penalized if you file required forms in an untimely fashion. If you cannot determine whether you are or are not receiving mortgage interest related to a trade or business, it may be best to go ahead and file the reports to avoid any penalties. Then seek the counsel of a competent accountant.

Since tax laws are constantly changing, it is always wise to consult a tax advisor.



Tips and Highlights

- You may be required to file Internal Revenue Code forms 1098 & 1099. Since tax laws are constantly changing, always consult with a tax advisor if you have any questions about reporting interest received.

To Use or Not to Use a Servicing Company

When you provide the financing for a property buyer, you need to choose whether or not to use a servicing company. Many note owners choose to use a servicing company (i.e. collection department of a financial institution or a private note servicing company) so that they 1) do not have to fill out 1098 and 1099 forms themselves and 2) can avoid having to track note payments and balances. Such firms will receive the payment, track the interest and principal, calculate the new balance, and issue the proper year-end reporting forms. Should you ever need to sell your note, using a servicing company can be a great asset. A servicing company will keep a record of the pay history, keep track of the current balance and any late charges, and may hold the original documents. All these are benefits that help you maintain your note. However, before you hire a servicing company you should carefully consider the following.

First, clarify what the servicer will and will not do. Some servicers will issue late payment reminders, charge appropriate late charges, and hold the original documents. Others will only provide such services for an extra fee. Most are not willing to handle a foreclosure in the event it becomes necessary.

A common mistake note owners make is assuming the servicing company will notify them if a payment is late or missing. Never assume the service provider will notify you. Some companies charge extra for this service.

Second, be aware that some of the servicing companies which hold your original documents *will not release your documents without both your signature and the signature of the payer.* (This is common in Alaska.) The following paragraph explains how this requirement could cause problems.

Quite often the best way to get top dollar for your note is to place it into a pool that will be securitized. Release of servicing can be a requirement of such a program, and if this is the case, coercing the property owner to release servicing so that you can sell your note for top dollar may be difficult. If you do not succeed, then your note will not qualify for the pool and you may have to settle for less than top dollar.

Proceed with caution before you hire a servicing company whose standard policy is to require the payer's written consent before releasing servicing. One way to circumvent this requirement is to place a clause in your security instrument that states the payer must consent to the release of servicing upon request or risk being considered in default.

Another creative way of handling this issue is to have the payer sign the required servicing release form in advance. It can then be used by the note owner at a later date if needed. Have the servicing company hold this original consent form and make sure they understand you intend to use it in the future. You want to

make sure they will honor the form, even if it will be used twenty years later.

The Payment History

If you choose to service your lien on your own, carefully document every payment made. This can be accomplished by keeping bank statements, deposit slips, or copies of each check. This requires a commitment of time on your behalf. Do not assume that, if needed, you could obtain proof of every payment from the property owner.

Why should you keep track of every payment? Your note is a valuable asset. Its value depends on many variables, one of which is the payment history. Do not minimize the importance of keeping accurate and up-to-date records. If you sell your note you will need to provide proof of all payments made, including the current balance, late charges, and the date through which interest is paid. Sound like a nightmare? It can be. This is one reason why loan servicing is popular.



Tips and Highlights

- Choosing to have your note serviced by the collection department of a financial institution or with a private note servicing company is a good idea, not only due to the IRS reporting requirements, but because you do not have to track note payments and balances.
- Should you ever need to sell your note, using a servicing company can be a great asset.

- Clarify what the servicer will and will not do. Never assume the service provider will notify you if a payment is late or missing.
- Proceed with caution before you hire a servicing company whose standard policy is to require the payer's written consent before releasing servicing. This could cost you money. You can, however, avoid this situation in two creative ways:
 1. Place a clause in your security instrument that states the payer must consent to the release of servicing upon request or risk being considered in default.
 2. Have the payer sign the required servicing release form in advance. It can be used by the note owner at a later date if needed.
- If you choose to service your lien on your own, carefully document every payment.

Avoid Adjustable Rate Notes

Adjustable rate notes have an interest rate that varies according to an index. This means that as the interest rate adjusts from time to time, so will the monthly payment.

We at Capital Solutions suggest you avoid creating adjustable rate notes. If you do attempt to structure an adjustable rate note, do so only with the help of a competent real estate attorney, since these loans may be regulated under Civil Code depending on state law. Federal regulations and usury laws may also come into play.

Unwanted Assumptions

For comments on how a due-on-sale clause can help protect you from unwanted assumptions, refer to page 42, “A Word on the Due-On-Sale Clause” section.

Use of The Property

In some cases, how and by whom a property is used will factor into how much a lien is worth. For example, properties that are occupied by someone other than the owner bring greater risk to the investor. In order to compensate for this risk, the investor will pay less for the lien than he or she would if the property were occupied by the owners.

Properties used for commercial purposes provide another example. In general, investors will pay less for a commercial lien than they will for a lien secured by a single family home. Once again, risk is the determining factor. However, other factors associated with commercial liens can also influence a note’s value. Underground fuel storage tanks provide a wonderful example. The environmental risks and regulations associated with underground fuel tanks are enormous, as are the financial costs of cleaning up a spill site. Therefore most investors will not purchase a lien secured by a property that has underground fuel tanks.

Many other property use variables can affect the value of a lien. A good rule of thumb is that anything which increases the note owner’s risk will decrease the market value of a note.



Tips and Highlights

- In some cases, how and by whom a property is used will factor into how much a note is worth. A good rule of thumb is that anything which increases the note owner's risk will decrease the market value of a note.

Purchase and Sale Agreement

Items contained in, or omitted from, purchase and sale agreements are very important if you plan on providing financing for the purchaser. For this reason, it can be a good idea to have a competent real estate attorney draft your purchase and sale agreement. Details involving the terms of the loan and any special clauses you will include should be disclosed in this agreement.

Acceptance of a purchase agreement means that your property is held off the market until closing occurs or the agreement is voided. You should therefore obtain preliminary data from the purchaser concerning his or her ability to repay the lien before you accept a purchase agreement. Once you accept the agreement, you can then gather additional in-depth data on the purchaser. Please refer to the section titled "Purchaser's Credit Worthiness" beginning on page 67 for tips on how to investigate a purchaser.

Placing multiple escape clauses into your purchase agreement is highly recommended. An escape clause allows you to avoid liability or performance of contractual obligations under certain conditions. In other words, these clauses can provide you a way out of the purchase agreement, thereby stopping the sale of your property to the prospective purchaser.

Examples of escape clauses that you, the property seller may want to consider would include being able to obtain acceptable credit report(s) on the purchaser(s), acceptable job history and proof of income, acceptable title policy (lender's policy), and all other variables which you deem to be important. You cannot put too many escape clauses into your contract. Even if the purchaser has terrible credit, no job, and/or no income, you can choose to go through with the sale of your property. However, if you choose to not go through with the sale, escape clauses allow you to void the purchase agreement and place the property back on the market, due to the purchaser failing to meet one of your requirements.

It is not uncommon for escape clauses to border on the ridiculous. Remember, the intent is to allow you to escape out of the purchase agreement. Ask for something you doubt the purchaser will go for. You can always choose to go ahead with the sale if (when) they fail to meet one of your conditions. Real estate attorneys are a wonderful resource for escape clauses. (The inclusion of escape clauses in this handbook comes from a suggestion by Mr. Richard Cogdell, an experienced property seller and client of Capital Solutions. Please refer to the section titled "Rewards for Suggestions" on page 107 for information on how you can contribute to the next edition of this handbook.)

Additionally, the time period allowed for investigations and property inspections should be specified within the purchase agreement. Should either party find something unsatisfactory, the terms of the purchase agreement can then be renegotiated. It is not unusual for buyers and sellers to counter the offer multiple times until a final agreement is reached or the offer dies.

The agreement should also detail which party pays for closing costs, as well as the time allowed for closing and what happens if either party defaults. Purchase agreements are extremely flexible. Take advantage of this flexibility and create a well-written purchase and sale agreement so that you can prevent problems that may arise later on.

Note: Clarify that your agent is acting only on your behalf. Try to avoid hiring a “dual agent.” Such agents work on behalf of both the buyer and seller. You want your agent to have a fiduciary responsibility to you alone.



Tips and Highlights

- Protect yourself by adding protective language and escape clauses to the earnest money agreement.
- Try to avoid hiring a “dual agent.” You want your agent to have a fiduciary responsibility to you alone.

Special Clauses

Special clauses, often called protective clauses, are additions you can place into your security instrument. The type of additions you can place into your security instrument will vary according to state law. Speak with your attorney about the following clauses and any others he or she might suggest.

- **Assignment Clause.** This clause states that the holder of the obligation (you) can assign interest in the obligation to a third party without permission from the borrower. It essentially clarifies

your right to sell or assign your interest to some one else without contacting the property owner.

- **Credit Inquiry Clause.** This clause states that the holder of the obligation has the right to make credit and employment inquiries of the payer at any time in the future. This clause clarifies your right to such information as well as the payer's duty to supply it.
- **Servicing Clause.** If you choose to use a servicing company, this clause states that the payer must consent to the release of servicing upon request or risk being considered in default. See the section titled "To Use or Not to Use a Servicing Company" on page 93 for additional information.
- **Appraisal Clause.** Since full appraisals are some times necessary to establish the value of a lien, this clause could be a lifesaver. Its purpose is to allow an appraiser access to the inside of the subject property upon your request.
- **Due-on-Sale Clause.** See the section titled "A Word on the Due-On-Sale Clause" on page 42 for additional information.
- **Right-To-Sue Clause.** This clause clarifies your right to personally sue the purchaser(s) should default occur.
- **Assumption Clause.** An assumption clause makes the note due and payable in full should the property be sold, assigned, or transferred without the written consent of the note owner. It provides you with additional protection from unwanted assumptions.

- **Tax and Insurance Clause.** This clause requires the property owner to send you proof that property taxes are paid. It can also be used for homeowner association dues as well.
- **Notice of Default Clause.** This clause requires the property owner to send you proof of payment on any senior liens, or risk being considered in default. This clause is used by junior lienholders who want assurance that senior liens are current.
- **Local Agent Clause.** This clause requires the property owner designate a local agent to whom notice is served in case of default. This is a good clause to use when the purchaser resides outside the United States or if his or her address is unknown.

State laws vary, sometimes tremendously. Language that is binding and appropriate in one state may not be in another. *As ridiculous as it sounds, a clause that is appropriate in one state may only be enforceable in a different state if it is typeset in a certain way (such as in bold or capital letters).* Likewise, some clauses must be in the note *and* the deed of trust to be enforceable. Always seek competent legal counsel when structuring and drafting a note.



Tips and Highlights

- Protect yourself by adding protective clauses to your note.
- A clause that is appropriate in one state may only be enforceable in a different state if it is typeset in a certain way. Likewise, some clauses must be in the note *and* the deed of trust to be enforceable.

- Always seek competent legal counsel when drafting a note.

Have Your Document Professionally Drafted

Have an *experienced* real estate attorney draft the note. Be careful whom you choose to draft your note. Some real estate professionals and attorneys draft documents that are virtually worthless. They may not have considered or they may simply be unfamiliar with how notes are treated on the secondary market. *The secondary market is so new that the information in this manual is not common knowledge.* Remember, the note you create will be in effect long after closing. The best way to protect yourself is through education, investigation, and, most important, competent legal counsel.

If you choose to use a standard deed of trust such as those which you can obtain from the local Board of Realtors, take it to your attorney and have additional safeguards added to it. While standard contracts are perfectly recordable, they are not tailored to protect your interests. More important, by using generic forms you miss the opportunity to obtain competent legal counsel. The changes your attorney makes to the standard contract may be minimal since the contract is approved by the local Board of Realtors. As such, your attorney costs should also be minimal. Remember, legal counsel can save you a lot of money in the long run.



Tips and Highlights

- The secondary market is so new that the information in this manual is not common knowledge.

- The best way to protect yourself is through education, investigation, and, most important, competent legal counsel.

Treat Your Original Documents as if They Were Cash

Your note is money in your hand. Notes are negotiable, transferable documents. Always know where your original documents are. You cannot sell what you cannot find. Should you lose your original documents, they will need to be recreated in order for you to sell all or part of the note. This costs you money and more importantly, time.

If you keep your original documents at your home, store them in a fireproof box. Better yet, store them away from your home in a safe deposit box at a bank or with your servicing company. If you store them away from your home, always keep copies for your own files.



Tips and Highlights

- Your note is money in your hand. Always know where your original documents are.
- If you keep your original documents at your home, store them in a fireproof box.

Summary: Top Ten Mistakes

1. **Mistake:** Failing to build adequate protective equity into the sales transaction.
Solution: For information on how to build adequate protective equity into the sales transaction, see pages 28, 44, and 55.
2. **Mistake:** Failing to examine credit reports on the purchaser(s) and to adjust the terms of the transaction appropriately.
Solution: For information on reviewing credit reports and other information on the purchaser, please see page 67.
3. **Mistake:** Failing to obtain a Preliminary Title Report in which the *purchaser* as well as the title is researched.
Solution: For information on Preliminary Title Reports and title insurance policies, please refer to page 70.
4. **Mistake:** Failing to annually check that the property owner has provided the appropriate amount of hazard insurance on the property and that the policy names you as beneficiary.
Solution: For information on insurance please refer to pages 34, 64, the checklist on page 66, as well as the Tax and Insurance Maintenance Log found on pages 111-112.
5. **Mistake:** Failing to annually check that property taxes have been paid.
Solution: For information on taxes please refer to pages 35, 62, the checklist on page 66, as well as the Tax and Insurance Maintenance Log found on pages 111-112.

6. **Mistake:** Failing to place special language into your security instrument which provides you additional protection.
Solution: For information on special clauses please refer to page 100.
7. **Mistake:** Not knowing how to prevent and/or stop unwanted assumptions.
Solution: For information on this topic please refer to page 42.
8. **Mistake:** Not knowing how to handle default.
Solution: Immediately seek the counsel of a competent real estate attorney. For step-by-step information on this topic see page 47.
9. **Mistake:** Failing to structure a lien so that if needed it can be sold for top resale value.
Solution: Read this handbook frequently. You may also find it helpful to speak with real estate attorneys who may have knowledge of the recent changes regarding owner financing and secondary markets.
10. **Mistake:** Failing to seek competent legal counsel when structuring and drafting your lien.
Solution: Always obtain competent legal counsel.

Afterword

Most of the information in this handbook is not common knowledge. Chances are good that anyone who has ever been a lienholder has made a few mistakes. The use of this handbook will hopefully be a benefit to you and any future mistakes you make will be small ones. If any of the information in this handbook was of

help to you, please let me know. I am interested in hearing your successes.

Rewards for Suggestions

If you have a good idea or topic you think would be valuable in this handbook, I would like to evaluate it for the next edition. To reward you for your effort you will be given credit for your contribution if it is used in the next edition. Please write or fax your ideas to the fax number and address found on page 123.



5

Getting Started

The following sections are designed to help you get started maintaining your note. The first section is an index of security instruments by state. Although there may be exceptions to this index, it is a quick reference of the most commonly used security instruments state by state.

The second section is our Tax and Insurance Maintenance Log. This two-page log will help you organize tasks key to the maintenance of your note. Although

this handbook is fully copyrighted, you are allowed to make copies of this form for your own use.

The second section titled “Selling All or Part of your note for Cash” is included so that you may better understand what options are available to you. This section covers a few of the more common questions asked by prospective clients.

Table 2: Security Instruments Used

| <u>State</u> | <u>Instruments</u> | <u>State</u> | <u>Instruments</u> |
|---------------|--------------------|----------------|--------------------|
| Alabama | M, D, L | Nevada | D, L |
| Alaska | D, L | New Hampshire | M, L |
| Arizona | D, M, L | New Jersey | M, D, L |
| Arkansas | M, D, L | New Mexico | M, D, L |
| California | D, L | New York | M, L |
| Colorado | D, M, L | North Carolina | D, L |
| Connecticut | M, L | North Dakota | M, L |
| Delaware | M, L | Ohio | M, L |
| Florida | M, L | Oklahoma | M, D, L |
| Georgia | S, L | Oregon | M, D, L |
| Hawaii | M, L | Pennsylvania | M, L |
| Idaho | M, D, L | Rhode Island | M, L |
| Illinois | M, T, L | South Carolina | M, L |
| Indiana | M, D, L | South Dakota | M, L |
| Iowa | M, D, L | Tennessee | D, M, L |
| Kansas | M, L | Texas | M, D, L |
| Kentucky | M, D, L | Utah | M, D, L |
| Louisiana | M, L | Vermont | M, L |
| Maine | M, L | Virginia | D, L |
| Maryland | D, M, L | Washington | M, D, L |
| Massachusetts | M, D, L | West Virginia | D, M, L |
| Michigan | M, L | Wisconsin | M, L |
| Minnesota | M, L | Wyoming | M, D, L |
| Mississippi | D, L | | |
| Missouri | D, L | | |
| Montana | M, D, L | | |
| Nebraska | M, D, L | | |

Note: Some states may recognize other

KEY: **L:** Land Contract
M: Mortgage
D: Deed of Trust
T: Trust Deed
S: Security Deed

ANNUAL TAX AND INSURANCE MAINTENANCE LOG

Fill out Section A of this form completely. The information you list is needed by either the tax office or the insurance provider when you make the annual phone calls described in the “Taxes and Insurance” section beginning on page 61. You may want to make a couple copies of this and the following page, since this information could change from property owner to property owner. If your note is secured by land only, simply leave the insurance section blank.

Section B on the following page is designed for recording your phone calls. It is here that you will record the name of the person with whom you spoke, the date and time you called, and the results of your inquiry. After completing this section, schedule a time to make the calls again next year, then file this form. *Schedule your call a week after the date property taxes become due; then you will know immediately if the property owner missed the payment date and you can take immediate action.*

Section A: Tax and Insurance Information

Tax office information:

Phone number of tax office: _____
 Tax ID number of property: _____
 Legal description of property: _____
 Full name of property owners: _____
 Date annual taxes are due: _____

Insurance office information:

Issuing insurance company: _____
 Policy number: _____
 Office phone number: _____
 Office address (optional): _____
 Insurance representative: _____
 Policy period: _____

Need assistance? Call us at 970-461-8429

Selling All or Part of Your Note For Cash

Capital Solutions specializes in purchasing all types of owner-financed liens throughout the United States. A few of the more common questions we encounter from prospective clients are listed below. This information is provided for your review so that you will be more familiar with your options and can therefore make informed decisions regarding your note.

I'm Not Quite Sure I Need to Sell My Note. Can You Tell Me What it Is Worth?

Yes, we can take a look at your note and tell you what it is worth. However, selling a note for no important reason is never in anyone's best interest. Furthermore, *how* we would structure the purchase of your note depends completely on your *needs and goals*. If you are just curious, and have not defined your needs and goals, you will need to do some planning before you call. Try to determine how much money you really *need*. A need for \$5,000 is quite different than a need for \$50,000. The structure of the sale between these two scenarios would vary tremendously.

How Much Will Capital Solutions Discount My Note?

Notes are purchased at a discount over the remaining balance due. However, by paying you some cash now and the remainder at a later date, we can give you the maximum amount possible. More often than not, the

sum of cash at closing and the sum at a later date is often equal to or greater than the full face value of your note.

The value of a note is determined by many factors. For example, a note secured by raw recreational land will be worth less than a note secured by a single-family home. Following are some of the variables that determine value:

- The type and location of the property serving as collateral.
- The terms of the note such as interest rate, number of years remaining, current balance, and owner's equity in the property.
- The market interest rates. Due to securitization, we are able to pay you much more today than we could in years past.
- The credit and pay history of the payer.
- The number of notes being purchased. Pools or portfolios are less risky and thus more valuable than individual notes.

For What Reasons Would I Want to Sell My Note?

Our clients sell their notes for many reasons. Here are some of the ones we at Capital Solutions encounter most often:

- The client needs a lump sum of cash to accomplish a major goal.
- The client has found a safer compounding investment with a higher yield, which increases in value rather than decreases as a note does.

- The client has concerns over the financial health of the owner and wants to eliminate the risk involved.
- The client has moved out of the area and can no longer easily check on the property, taxes, or insurance.

What Kind of Notes Will You Purchase?

We will purchase:

- Junior and senior position liens.
- Commercial liens.
- Residential liens.
- Land liens.
- Multifamily liens.
- New or unseasoned liens.
- “Equity” notes created as a result of divorce.
- Balloon payments.
- Portfolios.

Do You Purchase Notes at Time of Creation?

Yes. This is called a simultaneous closing. It is a great way to sell your property fast and receive all cash at closing. Regardless of whether you are a home seller or home buyer considering this option, you should contact us prior to entering into a sales agreement with the other party. We can give you an idea of what the market value of the proposed lien would be. Please call Capital Solutions at 1-888-372-9993 for more information.

What Are My Purchase Options?

We can purchase all or part of your lien. Partial purchases can be very flexible, with many variations on how the sale is structured. A common example of one type of a partial purchase is when we buy a stream of payments. After we receive those payments, the note reverts back to you and you begin collecting the monthly payments again.

A second example of a partial sale involves keeping a certain portion of each payment. This way you get a lump sum of cash now, plus an ongoing cash stream. Partial purchase options are flexible and often vary greatly from client to client depending on his or her needs.

What Are My Funding Options?

Funding normally occurs with one lump sum being paid to you. However, there are exceptions to this. For example, if your note was purchased in full, and we know in advance that you have special funding needs, *we can fund the amount owed to you any way you request*. Rather than receiving one lump sum, you may choose to receive monthly payments, a lump sum now and the rest at a specific later date, or any other payment schedule you desire.

You may find the flexible funding option attractive for several reasons.

- 1) This option often is used to spread out the tax consequences of selling a note. Since funding does not occur in one lump sum, many accountants take the position that capital gains tax, if any is owed, does not

need to be paid in full the year you sell your note. It is instead paid over time, as you receive cash from the sale of your note. *You will need to speak with your accountant to determine if this program would be beneficial to you.*

2) Flexible funding options may also be desired because the note seller is living on a fixed monthly income and needs to continue receiving monthly payments. This is often the case with elderly or disabled persons.

3) Another attractive aspect of the flexible funding program is that the amount owed to you is *100% guaranteed*. This means that if the payer defaults after you sell your note, that default has no effect on you. You will continue to receive the amount owed to you without change. Furthermore, because you are choosing to receive your funds spread out over time, *you will receive a return of 8 percent on the unpaid amount we owe you. The combination of guaranteed funding plus a return of 8 percent makes the flexible funding option attractive.*

Will Selling My Note Cost Me Anything?

Generally, you will not incur any costs. We pay all costs of transferring your note to us. You will receive your funds at closing in the form of a cashier's check, or if you desire, we will deposit the funds directly into the account of your choice. Should you choose this option, normally the only cost you will incur is the cost of the electronic transfer.

How Do I Sell My Note?

After you provide answers to a few initial questions, we will begin our research. This involves reviewing your security instrument and the closing statement from when you sold your property. This research takes approximately 24 hours from the time we receive your documents. (We prefer to receive documents via fax machine, but you may send *copies* of your documents to our mailing address. *Do not send us your original documents.* We will only need these at the time of closing.) Upon completion of our research, we will call you to discuss your options and to determine whether we have a program that will effectively meet your needs.

Having your lien professionally serviced can be very beneficial! Payers are more motivated to make payments to a corporation than they are to an individual, making default less likely.



6

Additional Services

The sections in this chapter are designed to give you further information on Capital Solutions and some of the ways in which we may be of further service.

The next section contains a list of additional services offered by Capital Solutions. Following is an explanation of how to contact the author, Christen J. Reinke. Since further editions of this handbook are anticipated, the author would like to hear your ideas and comments, whether they be negative or positive.

The last section in this chapter, titled “Discounts for Friends,” supplies information on how to obtain this manual for friends at a wholesale price.

Additional Services

Our Website: At our website, aaa-mortgagebuyers.com, you will find an on-line real estate bookstore, commonly asked questions and answers, loan originating services, additional information regarding note purchasing, and much more. Stop by and continue learning...

Mortgage Appraisals. If you are considering the sale of your portfolio or need to determine whether it is in your best interest to sell, having a certified note appraisal can be indispensable. Appraisals are also beneficial for:

- Investment planning.
- Evaluating portfolios.
- Estate and trust planning.
- Probate purposes.
- Determining net worth.
- Sale or transfer of assets.
- Tax purposes.

For more information please reference our mortgage appraisal web page.

Contacting The Author

This handbook was written by Christen J. Reinke, principal of Capital Solutions. Capital Solutions is a *nationwide note purchasing firm* specializing in helping Realtors close more transactions by utilizing techniques such as simultaneous closings and sub-prime lending. We place special importance on tailoring the purchase of owner financed liens to meet the specific funding and tax liability needs of our clients. Great care is taken to ensure that all possible funding options are fully understood, enabling our clients to make informed, educated decisions.

Our ultimate goal is to heighten the standards by which the note purchasing industry conducts business. Providing quality ongoing information to lienholders as well as to real estate professionals is one of the ways we are attempting to make a difference.

We invite you to call and inquire about our services.

Contact Information:

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(long distance) (888) 372-9993
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Internet address: <http://aaa-mortgagebuyers.com>

Discount For Friends

Do someone a favor. Give a friend or associate one of the vouchers found at the back of this book. The bearer is entitled to receive a *How to Avoid the 10 Biggest Mistakes When Owner Financing Real Estate* handbook at a 20 percent discount off the retail price.

Providing the voucher to a friend would not only be a nice thing to do, it would also help distribute this much-needed information to a wider audience. We at Capital Solutions believe that if just one person avoids a foreclosure or financial loss due to the information in this book, our goal in writing this publication will be accomplished. We therefore ask for your support in spreading the word about this handbook.

Voucher Instructions

Wholesale vouchers entitle the bearer to a *How to Avoid the 10 Biggest Mistakes When Owner Financing Real Estate* handbook at a 20 percent discount off the normal retail price of \$19.95. Simply give one to a friend or associate for completion. Have them fax or mail to the address listed at the bottom of the voucher and a copy of *How to Avoid the 10 Biggest Mistakes When Owner Financing Real Estate* will be promptly mailed to them. From time to time, we run special offers from our web site, such as an electronic e-book version for instant download. You may want to check out these offers: AAA-MortgageBuyers.com.

Glossary

A

Accrue. To increase, to grow.

Accrual Date. The date the lienholder begins to charge interest.

Accrued Interest. Interest that has been charged but not yet paid.

Addendum. An addition to a written document (e.g., a contract).

Alienation. Alienation occurs when title to a property passes to another party, such as when a property is sold.

Allonge. If there is no room on an original note for an endorsement, the endorsement is written on a separate piece of paper. It is then permanently attached to the original note and is called an allonge.

Amendment. An alteration or change to a written document (e.g., a contract).

Amortization. A method of equalizing monthly mortgage payments over the life of a loan. Payments usually are paid monthly but can be paid annually, quarterly, or on any other schedule. In the early part of a loan, repayment of interest is higher than that of principal. This relationship is reversed at the end of the loan.

Appurtenance. Something that belongs to someone else. An example would be the right to cross through someone else's property.

Assessment. Taxes or special payments owed to a municipality or association.

Assignee. The person to whom an agreement or contract is assigned. If you are assigning interest in your note to an investor, that investor would be the assignee.

Assignment. To transfer something from one party to another. For instance, a lienholder might transfer his or her interest to another party in exchange for a lump sum of cash.

Assignor. A party who assigns or transfers something to another. If you are assigning interest in your note to an investor, you are the assignor.

Assumption. An assumption occurs when a property owner sells his or her property, allowing the new owner to "assume" or take over payment of the mortgage. Most assumptions require the prospective buyer to meet certain financial criteria required by the lienholder. Some liens can be assumed without meeting any financial criteria. These are called non-qualifying assumable liens.

B

Balloon payment. A final payment of principal.

Barter. The exchange of goods and services for other goods and services without the use of money.

Beginning Balance. The sales price of a property minus the down payment and/or other considerations such as bartered items.

Beneficiary. One who benefits from the act of another, such as the beneficiary of a fire insurance policy, or the beneficiary of a deed of trust.

Breach of Contract. A default or failure to abide by the terms of the contract.

C

Cancellation Notice. A notice sent by the insurance carrier to the beneficiary of an insurance policy, stating that the policy has been cancelled and is no longer active.

Certificate of Title. A written statement, usually provided by a title company, which states that the title to a piece of property is legally owned by the present owner.

Certified Note Appraising. The appraisal of individual and multiple notes. Appraisers are certified by The American Appraisal Institute of Privately Held Notes and Mortgages.

Clear Title. Title that is not encumbered or burdened with clouds such as mortgages or unpaid taxes.

Cloud on Title. Any encumbrance or burden that adversely affects title to a property. Examples would include liens or unpaid taxes.

Commit Waste. Failure to maintain property or allowing property to be used in a way that reduces its value.

Convey. To pass or transfer title to another party.

Conveyance. The document used to transfer property from one party to another.

Credit Bureau. Firms that collect information on individuals and businesses for the purpose of providing the information to subscribers.

Credit Report. A report from a credit bureau that provides a credit rating and other financial data on a person or a company.

D

Debt Instrument. A written promise to repay debt(s).

Deed of Trust. Similar to a mortgage, it is an instrument used by some states to secure the repayment of money.

Default. A failure to abide by the terms of the contract.

Down Payment. Money paid at the execution of a deed of trust (lien).

Due-On-Sale Clause. A clause in a note that allows the note owner the option of calling a loan due and payable when the property is sold. This clause is designed to protect the lienholder from unwanted assumptions.

E

Earnest Money. Money paid by a buyer at the time of entering a contract. It indicates the buyer's intent to carry out the contract.

Easements. A right of use over the property of another. A utility easement, for example, allows the utility company to lay its lines across another's property.

Encumbrances. Any right or interest in land that affects its value. Examples would include liens, easements, and unpaid taxes.

Endorsement. Assigning or transferring a lien to another person is accomplished through the use of an endorsement. The words "PAY TO THE ORDER OF:" and then the name of the person to whom the lien is being assigned to, is written. If there is not enough space on the original note to write an endorsement, it is written on a separate piece of paper that is permanently affixed to the original note. This is called an allonge.

Escape Clause. A way out. This is a clause in a legal document that allows a party to avoid liability and/or the performance of contractual obligations under certain conditions.

Escrow Account. A bank account into which funds are paid, usually for the fulfillment of a mortgage or other contract.

F

Fiduciary. Having a duty to act primarily for another's benefit. If you hire an attorney, for example, that attorney has a duty to act primarily for your benefit.

Fixture. Something that is attached to land, becoming part of the real estate. Examples are wells or fencing.

Foreclosure. The sale of mortgaged property. Proceeds from the sale go to the lienholders as repayment.

G

Grace Period. A period of time granted by a loan agreement during which default will not occur even though payment is overdue. Your contract may or may not have a grace period.

Grantee. Also called the mortgagee. If you own a note, you are the grantee or mortgagee. The grantee is the person to whom a grant or promise is made.

Grantor. Also called the mortgagor and debtor. If you own a note, the grantor is the person who makes payments to you. In technical terms, it is the person who makes a grant.

H

Hazard Insurance. An insurance policy purchased by a property owner to insure against fire, theft, vandalism, etc. Most security instruments require the owner to carry hazard insurance to protect the seller from loss.

Hereditaments. Things capable of being inherited.

I

Improvements. A valuable addition made to property.

Impute. To put in place. Example, to impute interest means to begin charging interest.

Insurance Binder. Proof of insurance. It is usually a one page summary of the insurance coverage.

Insurance Premium. The price of an insurance policy. Insurance premiums can be paid monthly, just like a mortgage.

Interest. A right or entitlement. For example, you can assign your interest in your note to a third party. This means you assign your right to collect monthly payments to someone else.

Interest Rate. A percentage of money charged for the use of such money; usually described in annual terms (e.g., 10 percent).

J

Junior Lien. A lien which is subordinate to a prior lien; a lien that was recorded after another lien. Junior liens have fewer legal rights than a lien in first position.

L

Land Contract. Contract for the purchase and sale of land. Title to the land is transferred upon execution of the contract. This means the property seller retains title to the land until the loan is paid off. The term commonly refers to an installment contract for the sale of land whereby a purchaser (vendee) receives the deed from an owner (vendor) upon payment of a final installment. The vendor/seller finances the sale for the buyer and retains legal title to the property as security. Equivalent terms are “contract for deed” and “installment land contract.”

Lessee. The person who makes lease payments. One who has right of possession and use of a property under the terms of a lease.

Lessor. The person who receives lease payments. One who leases property.

Legal Description. A technical description of real estate by government survey, metes and bounds, or lot numbers of a recorded plat. It also includes descriptions of any easements or reservations.

Lien. A type of security instrument (i.e., a tax lien), placed against property, making it security for the payment of a debt, judgment, mortgage, or taxes. If the lien is not paid, the lienholder has the right to confiscate the property in order to recover the money that was loaned.

M

Market Value. The price a note commands in the open market.

Metes and bounds. Boundary lines of land. A method of accurately measuring and describing land.

Mortgagee. A person who takes, holds, or receives a mortgage; the mortgage owner; the payee.

Mortgagor. The person who creates a mortgage. The person who pays the mortgage owner; the payer; usually the property owner.

Mortgage. A lien that provides security for the repayment of the loan.

N

Negative Amortization. This is a situation that occurs when monthly payments are not large enough to cover the interest owed. The interest that is not covered is added to the principal, which can increase to more than the amount borrowed.

Non-Acceleration Letter. A letter from a junior lienholder to a senior lienholder requesting the senior lienholder not accelerate the loan should you keep it current during a foreclosure.

Note. A written promise to pay a sum of money at a specified time to a specified person or party.

Notice of Default. A letter sent to a party in default reminding them that they are in default.

O

Owner Financing. Also called “Carrying Paper,” “Purchase Money Mortgage,” or “Seller Carry-Back Financing,” owner financing occurs when the seller of a property finances the property for a buyer. A security instrument is thus created to secure the performance of that financing.

P

Party. A person taking part in a transaction or proceeding.

Payee. The person to whom a payment is made.

Payer, or Payor. The person who makes a payment. The payer pays the payee.

Payment. A previously agree-upon dollar amount paid in regular installments.

Plat. A map of a specific area showing details such as streets, alleys, subdivided lots, easements, etc.

Promissory Note. See note.

Protective Equity. The difference between fair market value and total debt owed on a property. It is protective because without it, if you had to foreclose, you would have little chance of recovering the amount owed to you after paying attorney fees, real estate commissions, fix-up costs, and other costs.

Purchaser. Someone who acquires property; the buyer. Technically, it is someone who acquires property in any manner other than by descent.

R

Real Estate. A parcel of land and everything attached to it.

Reserve. Funds set aside to cover future expenses such as taxes and insurance.

Return on Investment. The amount earned per year on an investment, usually expressed as a percentage of the investment.

S

Seasoning. This term refers to the pay history on a loan. A loan that is “seasoned” will have at least six months of pay history. Notes that are brand new, having only a few payments received, are non-seasoned. Non-seasoned loans are more risky than seasoned loans because they lack a pay history.

Secondary Market. The primary market is where securities are originally created. A secondary market is where securities are bought and sold after their original issue.

Securitization. The pooling and selling of huge portfolios of privately-held mortgages to public investors (in a secondary market).

Security. Something given as a pledge of payment.

Seller. One who has contracted to sell property.

Senior Lien. A lien that has been recorded before another. A lien that was recorded after a previous lien is called a junior lien. Liens that are in first position have more legal rights than junior liens.

T

Tax Auction. A public sale of property to the highest bidder as repayment for delinquent taxes.

Tax ID Number. An identification number usually given by a borough, municipality, or county to a property parcel for tax purposes. This is the number a tax office will ask you for when you call to find out if taxes have been paid.

Tenements. Possessions that are permanent and fixed to land.

Term. The length of a loan, usually stated in months or years.

Title. Written evidence that the owner of the land has lawful possession.

Trustee. One designated to hold property for another, pending the performance of an obligation. In a deed of trust state, the trustee is often the title company that handled the property sale closing.

Trustor. The payer of the lien. In a deed-of-trust state, this is the purchaser of the property.

Trust Deed. The legal document used to create a trust.

U

Usury. Charging an illegal rate of interest. Violating usury law means the interest charged is above what is permitted. Different states have different usury laws.

W

Warranty Deed. A deed that conveys or transfers title from one party to another. It also includes covenants to assure that the title transferred is free from all encumbrances.

Waste. See Commit Waste.

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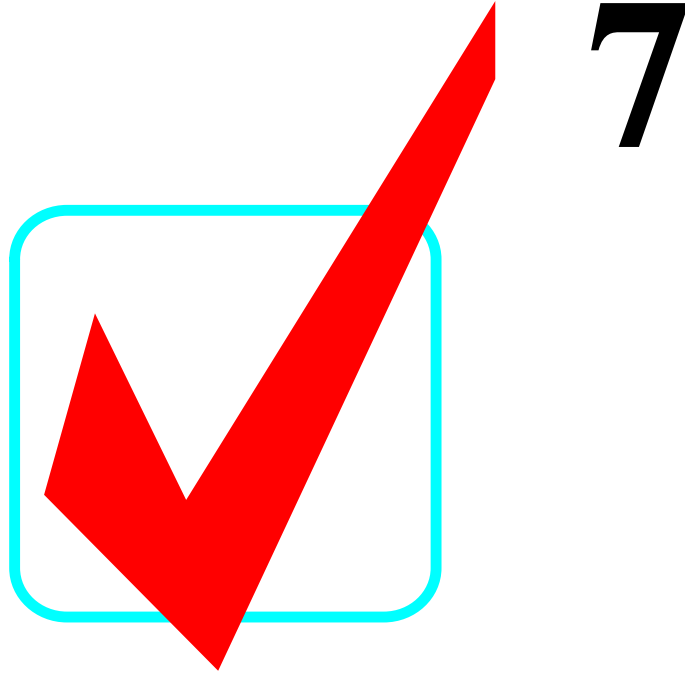
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Addendum: Checklists

Checklists For Property Sellers & Buyers

While owner financing is a wonderful way to move property, if you are able to buy or sell through conventional means, by all means do so. It is not the intent of this book to teach owner financing as if it were the best and/or only means to that end. Rather, owner financing should be used as a tool when circumstances warrant its use, such as the following:

- When needing to selling property fast.
- When the property is unique or does not meet lender requirements (example: raw land, condominiums).
- When the buyer does not meet lender requirements (example: poor credit, past bankruptcy, no credit, etc.).
- When the seller wants to “carry paper” as an investment or business.
- When the real estate market is sluggish or slow.

Following are two step-by-step checklists, designed to streamline either the home selling or home buying process. Simply refer to the checklist which applies to you.

Home Seller Checklists

If Property Qualifies; Buyer Does Not

If you are having difficulty selling your property because the buyers cannot qualify at a bank, but your property will meet all lending requirements, simply have the buyer fill out and fax us the four page loan application which is included in this e-book. We work with sub-prime lenders throughout the United States and are often successful at originating loans for persons who have been turned down elsewhere. This includes residential as well as commercial loans. If your prospective buyer has been turned down elsewhere, they can simply send us the same loan application they originally gave to the lender who turned them down. There is no need for them to fill out the application a second time, unless their financial situation has changed.

- 1. Print out the loan application, preferably onto legal sized paper if available.
- 2. Ask your prospective buyer to fill out the application completely and fax to Capital Solu-

tions at 1-888-835-7040. They may also call us at 1-888-372-9993. (The application can be somewhat confusing.)

- 3. Give us a few business days to evaluate your buyer and fit them into a program. We work with a number of wholesale lenders, often contacting more than one lender in order to place the loan. Please be patient during this time period. If we are not successful, you will probably need to find another buyer. Chances are they have something very negative, such as lack of employment, and will not qualify anywhere. If you decide at this point to owner finance the property to the same buyer, it will be very risky. Even if you eliminate the risk of owning the note by selling it at closing (see the next section for more details), chances are the note will be discounted greatly, or you will need to sell part of the note verses the entire note. (An exception to this would be if the buyers were able to make a large down payment.)

- 4. If we are able to originate a loan for your buyer, the transaction will commence just as a conventional loan origination would, giving you all cash at closing.

If the Property Does Not Qualify and/or the Buyer Does Not Qualify

If the property does not qualify for financing, you will need to owner finance the property. If the property will meet conventional lending requirements, but the problem is the prospective buyer, we may be able to originate a sub-prime loan for you. Please see the previous section.

For the purposes of this section we will assume you have found a buyer and need to owner finance the property, contingent upon us purchasing the note at closing. This will give you, the property seller, all cash at closing, just like a traditional transaction.

To clarify, this type of transaction is called a “simultaneous closing”. It is in essence, two separate closings, occurring simultaneously. The first closing passes title to the property from the seller to the buyer. At this time the owner financed lien is created, and the buyer is now responsible for making monthly payments. Subsequently, a second transaction occurs wherein the lien that was created during the first closing is now sold to Capital Solutions. The end result is that the seller obtains all cash at closing, the buyer is able to purchase a property by avoiding the bank, and the Realtor makes a commission. A unique solution for all parties.

The following checklist will help you understand how these transactions are accomplished. It is assumed that you have located a prospective buyer.

- 1. Print out the credit application, preferably onto legal sized paper if available.
- 2. Ask your prospective buyer to fill out the application completely and fax to Capital Solutions at 1-888-835-7040.

(Remember, lien structure involves a large many of the variables discussed in this book such as interest rate, length of the loan, principal balance, balloon payments, if any, etc. Since these variables affect the price we pay you for the lien, work with the buy-

ers to try to “build in” as many of these variables as possible, thus assuring you, the lien seller, top dollar at closing.)

- 3. Give us a few business days to evaluate your buyer and fit them into a program. During this time period we will pull credit and speak with your real estate agent (if one is involved) to obtain the specifics regarding the property. We will then contact you or your real estate agent and explain a few of your options so you can make an informed decision.

- 4. Should you decide to go ahead with the transaction, the next step is to have a real estate purchase agreement drawn up and signed by all parties. You will need to fax this into us as well. You can obtain purchase agreements from your real estate agent, or from the real estate board.

This purchase agreement will list all the details of the transaction, including who pays for the appraisal and who pays for the title policy. With simultaneous closings, a full appraisal is needed on the subject property, as well a lender’s title policy. (The buyer will probably want an owner’s title policy for their own use, which can be drawn up for minimal cost.) Make sure the purchase agreement states that the transaction is contingent on Capital Solutions buying the note at closing. Also make sure the agreement states that the transaction is subject to approval by the note purchaser. This gives you an escape clause in case our investigation of the property or purchaser turns up any previously unknown negative items.

- 5. Our underwriting committee will review the transaction before money is spent on appraisal or title. Assuming everything looks fine, the appraisal and title will then be ordered, usually by us. Once these items come in, our underwriting committee will review the transaction a second time. Assuming the file passes final underwriting review, we will set up closing and fund as quickly as possible.

Home Buyer Checklists

If Property Qualifies; Buyer Does Not

If you are having difficulty buying a property because you cannot qualify at a bank, but the property you wish to purchase does meet lending requirements, simply fill out and fax us the four page loan application which is included in this e-book. We work with sub-prime lenders throughout the United States and are often successful at originating loans for persons who have been turned down elsewhere. This includes residential as well as commercial loans. If you have been turned down elsewhere, you can simply send us the same loan application you originally gave to the lender who turned you down. There is no need for you to fill out the application a second time, unless your financial situation has changed.

- 1. Print out the loan application, preferably onto legal sized paper if available.
- 2. Fill out the application completely and fax to us at 1-888-835-7040. Please also call us at 1-888-372-9993, so we can answer any questions you may have.
- 3. Give us a few business days to evaluate your application and fit you into a program. We

work with a number of wholesale lenders, often contacting more than one lender in order to place the loan. Please be patient during this time period. Also understand that due to increased risk, the interest rate on your mortgage will probably be higher than that of a conventional loan. Know that sub-prime loans will help you reestablish credit. Should you make payments as agreed, you stand a good chance of refinancing to a lower interest loan in the future. (Don't be surprised if a year from now, we give you a call asking if you would like to refinance to a lower interest rate.)

- 4. If we are able to originate a loan for you, the transaction will commence just as a conventional loan origination would.

If the Property Does Not Qualify and/or the Buyer Does Not Qualify

If the property does not qualify for conventional financing, you will need to ask the property seller to owner finance the property to you. However, if you as the property buyer, do not qualify, but the property does, we may be able to originate a sub-prime loan for you. Please see the previous section. The real estate agent involved will usually know if the property meets lending requirements or not.

For this section we will assume that owner financing is necessary and that you have found a property and are willing to ask the seller to owner finance the property, contingent upon us purchasing the note at closing. This will give the property seller all cash at closing, just like a traditional transaction, while you enjoy the benefit of not qualifying at a bank. Do not assume that the property seller will have any idea of what a "simultaneous closing" means. The concepts in this book are new and

not well known. We will of course, help you in putting this type of transaction together, including speaking with the property seller and any real estate agents who are involved.

To clarify, this type of transaction is called a “simultaneous closing”. It is in essence, two separate closings, occurring simultaneously. The first closing passes title to the property from the seller to the buyer. At this time the owner financed lien is created, and you the buyer are now responsible for making monthly payments. Subsequently, a second transaction occurs wherein the lien that was created during the first closing is now sold to Capital Solutions. The end result is that the seller obtains all cash at closing, you are able to purchase a property and avoid the bank, and the Realtor makes a commission. A unique solution for all parties.

The following checklist will help you understand how these transactions are accomplished. It is assumed that you have located a property. If you have not located a property yet, please see the section titled “Tips For Finding Property” at the end of this section.

- 1. Print out the credit application, preferably onto legal sized paper if available.
- 2. Fill out the application completely and fax to Capital Solutions at 1-888-835-7040. We also encourage you to call us at 1-888-372-9993 so that we can discuss your particular situation. (Lien structure involves many of the variables discussed in this book such as interest rate, length of the loan, principal balance, balloon payments, if any, etc. Remember, these variables affect the price we pay the property seller for the lien, and

therefore are extremely important for a successful transaction.

Try to “build in” as many of these variables as possible, while making sure you are comfortable with the terms.)

- 3. Give us a few business days to evaluate your application and fit you into a program. During this time period we will pull credit and speak with your real estate agent (if one is involved) to obtain the specifics regarding the property. We will then contact the agent and explain a few purchase options so the agent can present the offer to the property seller.

- 4. Should the property seller decide to go ahead with the transaction, the next step is to have a real estate purchase agreement drawn up and signed by all parties. You will need to fax this into us as well. You can obtain purchase agreements from your real estate agent, or from the local real estate board.

This purchase agreement will list all the details of the transaction, including who pays for the appraisal and who pays for the title policy. With simultaneous closings, a full appraisal is needed on the subject property, as well a lender’s title policy. (You will probably want an owner’s title policy for your own use.) Make sure the purchase agreement states that the transaction is contingent on Capital Solutions buying the note at closing. Also make sure the agreement states that the transaction is subject to approval by the note purchaser. This gives you an escape clause in case our investigation of the property or purchaser turns up any previously unknown negative items.

Note: It would be helpful for you to pay for appraisal and title costs, since the property seller will be taking a discount on the note. You will thus increase your chances of having your purchase agreement accepted by doing so.

- 5. Our underwriting committee will review the transaction before money is spent on appraisal or title. Assuming everything looks fine, the appraisal and title will then be ordered, usually by us. Once these items come in, our underwriting committee will review the transaction a second time. Assuming the file passes final underwriting review, we will set up closing and fund as quickly as possible. You then become a new homeowner!

Tips For Finding Property

Finding property to buy via owner financing is a task that can be confusing. Unless the property is listed as ready for owner financing, you have no way of knowing who will and who will not consider the use of a simultaneous closing. There are however, a few tricks that can aid your search.

First, have a real estate agent pull up all real estate listings that have been on the market for awhile. Depending on the market where the property is located, this could be as short of a time period as 30 days, or as long as 180 days. The goal is to obtain a listing of all properties which are not being sold quickly. Your agent will know this.

Second, have your agent take all the properties that are slow moving, and filter out all the ones in which the

seller has a lot of debt to pay off out of closing. Properties that are worth, for example, \$100,000. but only have liens amounting to \$60,000. are great candidates. What you are looking for is equity. Since the seller will have to take a discount on the owner financed note, you want to make sure the seller has enough equity so that they will walk away from closing with cash in hand after they pay off any current debt, closing costs, and real estate commissions. You may be surprised to know that about 60 percent of all property is owned free and clear. It may thus be easier than you think to find this type of property, particularly in older neighborhoods where people are less transient.

Third, have your agent print out the “spec” sheets on each of the properties that remain. On your own time, (not your agents) drive by each of the properties and categorize them into two lists. One list for properties that you interested in, the second list for all other properties. List number one is the list you should now take to your agent and ask to inspect. You may only have a couple properties in your list if you did a good job of filtering, based on length of time on the market, sellers equity, and your drive-by.

Inspect the properties in list number one, and decide if you would like to make offers on any of them. (Remember that the more offers you make, the better your chances of finding a seller ready to do business.)

Before making an offer, send us your credit application and the details of the property. We will be able to tell your agent what we could pay for the mortgage that will be created and then simultaneously sold at closing. With this information, a purchase offer can be

drawn and presented to the seller. The seller will thus have actual figures in from of him or her to consider.

If the offer is rejected, keep going down your lists of properties. We sometimes find that real estate agents are hesitant to make offers such as these due to a lack of education and general non-familiarity with owner financing. In situations like this, you may be better off obtaining the services of another agent who is more familiar with owner financing. You can also call us and we will work with you and any agents involved.

Hopefully this information has been helpful to you. If you have any questions, you may contact us at the following numbers:

Contact Information:

Christen J. Reinke, Capital Solutions
Phone: (888) 372-9993
Fax: (888) 835-7040
E-mail: info@aaa-mortgagebuyers.com
Internet address: www.AAA-MortgageBuyers.com

Capital Solutions
Christen J. Reinke; 1-888-372-9993
Instructions: Fill out and fax to 1-888-835-7040

Credit Application

Date: _____

| | | | | | | |
|--|--|--|--|---|---------------------------|-------------------------------------|
| CHECK ONE | <input type="checkbox"/> If you are applying for individual credit in your own name, are not married, and are not relying on alimony, child support, or separate maintenance payments or on the income or assets of another person as the basis for repayment of the credit requested, complete only Sections A, D & E. <input type="checkbox"/> In all other situations, complete all Sections, providing information about your spouse, a joint applicant or the person on whose alimony, support, or maintenance payments or income or assets you are relying. | | | | | |
| SECTION A. Information Regarding Applicant | Full Name (Last, First, Middle) | | Birthdate | Social Security Number | No. of Dependents & Ages | |
| | Present Street Address (Street, City, State, Zip) | | | Home Phone | How Long There? | |
| | Previous Street Address (Street, City, State, Zip) | | | How Long There? | | |
| | Present Employer | How long employed? | Bus. Phone | Position or Title | Name of Supervisor | |
| | Employer's Address | | | | | |
| | Previous Employer | How long employed? | Previous Employer's Address | | | |
| | Present Net Salary/Commission per | *Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation. (If it is to be considered, please include that amount in "Other" income below.) Alimony, child support, separate maintenance received under: court order <input type="checkbox"/> written agreement <input type="checkbox"/> oral understanding <input type="checkbox"/> | | | | |
| | Other Income* per | Sources of other income: | | | | |
| | \$ | Is any income listed in this Section likely to be reduced before the credit requested is paid off? <input type="checkbox"/> Yes <input type="checkbox"/> No If yes, please explain in detail on separate sheet. | | | | |
| | Name of nearest relative not living with you | | Relative's address (Street, City, State, Zip) | | Phone No. | Relationship |
| SECTION B. Information Regarding Joint Applicant, Spouse, or Other Party | Full Name (Last, First, Middle) | | Birthdate | Social Security Number | Relationship to Applicant | |
| | Present Street Address (Street, City, State, Zip) | | | Home Phone | How long there? | |
| | Present Employer | How long employed? | Bus. Phone | Position or Title | Name of Supervisor | |
| | Employer's Address | | | | | |
| | Previous Employer | How long employed? | Previous Employer's Address | | | |
| | Present Net Salary/Commission per | *Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation. (If it is to be considered, please include that amount in "Other" income below.) Alimony, child support, separate maintenance received under: court order <input type="checkbox"/> written agreement <input type="checkbox"/> oral understanding <input type="checkbox"/> | | | | |
| | Other Income* per | Sources of other income: | | | | |
| | \$ | Is any income listed in this Section likely to be reduced before the credit requested is paid off? <input type="checkbox"/> Yes <input type="checkbox"/> No If yes, please explain in detail on separate sheet. | | | | |
| | Name of nearest relative not living with Joint Applicant, Spouse, or Other Party: | | Relative's address (Street, City, State, Zip) | | Phone Number | |
| | Relationship to Joint Applicant, Spouse, or Other Party | | No. of Dependents of Joint Applicant, Spouse, or Other Party & Ages. | | | |
| SECTION C. Marital Status | Applicant: <input type="checkbox"/> Married <input type="checkbox"/> Separated <input type="checkbox"/> Unmarried (incl. single, divorced, & widowed) | | Fire Insurance Co. insuring Collateral: | | | |
| | Other Party: <input type="checkbox"/> Married <input type="checkbox"/> Separated <input type="checkbox"/> Unmarried (incl. single, divorced, & widowed) | | Name & Address of Agent: | | Phone Number | |
| SECTION D. Real Estate Security | Briefly describe property to be given as security: | | | | | |
| | Address of property: (Street, City, State, Zip) | | Amount of Ins. \$ | Exp. Date / / | Policy No. | Premium \$ per |
| | Yr. Acquired | Orig. Cost \$ | Mort. or Contract Bal. \$ | Mo. Pymts. \$ | Interest Rate(s) % | Mortgage Co. or Escrow Agent/Branch |
| | Description of any improvements since acquired | | | | | Cost of Improvements \$ |
| | Full Name of Applicant's Spouse | | | Full Name of Spouse of Joint Applicant or Other Party | | |
| | Full Names and Addresses of Any Co-Owners of the Property: | | | | | |
| SECTION E. Asset and Debt Information (include any unsatisfied judgments) | If Section B has been completed, this Section should be completed giving information about both the Applicant and Spouse, Joint Applicant or Other Party. Please mark Applicant information with an "A." If Section B was not completed, only give information about the Applicant in this Section. | | | | | |
| | ASSETS | | (if maintained in other name, list name) | | | |
| | | | LIABILITIES | | BALANCE | MO. PYMT. |
| | Cash on Hand or in Bank | \$ | Loans from Banks, Finance Co's. | | \$ | \$ |
| | Automobile, Make & Year | \$ | Automobile financed by | | | |
| | Real Estate - Date Purchased & Purchase Price | \$ | Mortgage Holder or Landlord | | | |
| | Stocks & Bonds (Current Market Value) | \$ | Budget, or Charge Accounts | | | |
| | Cash Surrender Value of Life Insurance | \$ | | | | |
| | Other Assets (Please List) | | | | | |
| | | | | | | |
| | | | Allimony or Child Support Owing | | | |
| | | | Credit Unions | | | |
| TOTAL ASSETS | | \$ | TOTAL LIABILITIES | | \$ | \$ |

Everything that I have stated in this application is correct to the best of my knowledge. I understand that you will retain this application whether or not it is approved. You are authorized to check my credit and employment history and to answer questions about your credit experience with me.

Applicant's Signature _____

Date _____

Other Signature (where applicable) _____

Date _____

AAA Mortgage Buyers

Mortgage Appraising & Purchasing

Real Estate Note Quote Request Form

Instructions: Fill out both pages as completely as possible. Your real estate documents will contain most of the information you need to fill this form out. Please do not forget to fill out your name and telephone number! After completion, fax or mail it to us **along with copies of your documents.** Call if you get stuck: 1-888-372-9993.

From: _____

Phone: _____ **Fax:** _____

Property Address & Description (Sq. Ft., # of BR, BA): _____

Legal Description: _____

Property Type:

- Owner Occupied House?
- Rental House?
- Multi-Family Dwelling?
- Commercial Property?
- Land? If so, is it :
- Recreational Land?
- Raw Land?
- Improved; Ready-To-Build-Upon Land?
- Other? Explain: _____

Selling Price: \$ _____ Current Value of Property: \$ _____

Down Payment: \$ _____ Payer Name(s): _____

1st Lien Amount \$ _____ Payer(s) SS #: _____

2nd Lien Amount \$ _____ Payer(s) Employer: _____

| | <u>1st Position Note:</u> | <u>2nd Position Note:</u> |
|--------------------------------|--------------------------------------|--------------------------------------|
| Date Mortgage Was Created: | _____ | _____ |
| Original Balance | \$ _____ | _____ |
| Interest Rate | % _____ | _____ |
| Length of Loan | _____ | _____ |
| Exact Payment Amount (P&I) | \$ _____ | _____ |
| Date Of First Payment | _____ | _____ |
| Date Of Next Payment | _____ | _____ |
| Balloon Date, if applicable: | _____ | _____ |
| Balloon Amount, if applicable: | \$ _____ | _____ |
| Number Of Payments Made | _____ | _____ |
| Number Of Payments Left | _____ | _____ |
| Current Balance | \$ _____ | _____ |

Any late payments? If so, how many? _____

How much of your note are you thinking about selling (there are many options)?

Do you have special tax liability issues that we should be aware of? Some programs may allow you to defer capital gains tax. Also list any current mortgage balances:

Borrower Signature Authorization

Privacy Act Notice: This information is to be used by the agency collecting it or its assignees in determining whether you qualify as a prospective mortgagor under its program. It will not be disclosed outside the agency except as required and permitted by law. You do not have to provide this information, but if you do not your application for approval as a prospective mortgagor or borrower may be delayed or rejected. The information requested in this form is authorized by Title 38, USC, Chapter 37 (if VA); by 12 USC, Section 1701 et. seq. (if HUD/FHA); by 42 USC, Section 1452b (if HUD/CPD); and Title 42 USC, 1471 et. seq., or 7 USC, 1921 et. seq. (if USDA/FmHA).

Part I - General Information

| | | | |
|----------------|----------------|--------------------------------------|--|
| 1. Borrower(s) | | 2. Name and address of Lender/Broker | |
| 3. Date | 4. Loan Number | | |

Part II - Borrower Authorization

I hereby authorize the Lender/Broker to verify my past and present employment earnings records, bank accounts, stock holdings, and any other asset balances that are needed to process my mortgage loan application. I further authorize the Lender/Broker to order a consumer credit report and verify other credit information, including past and present mortgage and landlord references. It is understood that a copy of this form will also serve as authorization.

The information the Lender/Broker obtains is only to be used in the processing of my application for a mortgage loan.

Borrower

Date

Borrower

Date

EQUAL CREDIT OPPORTUNITY ACT

APPLICATION NO:

PROPERTY ADDRESS:

The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal Agency that administers compliance with this law concerning this Mortgage Company is the Federal Trade Commission, Pennsylvania and 6th Street N. W., Washington, D. C. 20580.

We are required to disclose to you that you need not disclose income from alimony, child support or separate maintenance payment if you choose not to do so.

Having made this disclosure to you, we are permitted to inquire if any of the income shown on your application is derived from such a source and to consider the likelihood of consistent payment as we do with any income on which you are relying to qualify for the loan for which you are applying.

(Applicant) (Date)

(Applicant) (Date)

(Applicant) (Date)

(Applicant) (Date)

Uniform Residential Loan Application

This application is designed to be completed by the applicant(s) with the lender's assistance. Applicants should complete this form as "Borrower" or "Co-Borrower", as applicable. Co-Borrower information must also be provided (and the appropriate box checked) when the income or assets of a person other than the "Borrower" (including the Borrower's spouse) will be used as a basis for loan qualification or the income or assets of the Borrower's spouse will not be used as a basis for loan qualification, but his or her liabilities must be considered because the Borrower resides in a community property state, the security property is located in a community property state, or the Borrower is relying on other property located in a community property state as a basis for repayment of the loan.

I. TYPE OF MORTGAGE AND TERMS OF LOAN

| | | |
|--|--------------------|--------------------|
| Mortgage Applied for: <input type="checkbox"/> V.A. <input type="checkbox"/> Conventional <input type="checkbox"/> Other: | Agency Case Number | Lender Case Number |
| <input type="checkbox"/> FHA <input type="checkbox"/> FmHA | | |
| Amount \$ | Interest Rate % | No. of Months |
| Amortization Type: <input type="checkbox"/> Fixed Rate <input type="checkbox"/> Other (explain): <input type="checkbox"/> GPM <input type="checkbox"/> ARM (type): | | |

II. PROPERTY INFORMATION AND PURPOSE OF LOAN

| | |
|---|--------------|
| Subject Property Address (street, city, state, ZIP) | No. of Units |
| Legal Description of Subject Property (attach description if necessary) | Year Built |

| | |
|---|--|
| Purpose of Loan <input type="checkbox"/> Purchase <input type="checkbox"/> Construction <input type="checkbox"/> Other (explain): <input type="checkbox"/> Refinance <input type="checkbox"/> Construction-Permanent | Property will be: <input type="checkbox"/> Primary Residence <input type="checkbox"/> Secondary Residence <input type="checkbox"/> Investment |
|---|--|

Complete this line if construction or construction-permanent loan.

| | | | | | |
|-------------------|------------------|--------------------------|-----------------------------|-----------------------------|----------------|
| Year Lot Acquired | Original Cost \$ | Amount Existing Liens \$ | (a) Present Value of Lot \$ | (b) Cost of Improvements \$ | Total (a+b) \$ |
|-------------------|------------------|--------------------------|-----------------------------|-----------------------------|----------------|

Complete this line if this is a refinance loan.

| | | | | |
|---------------|------------------|--------------------------|----------------------|---|
| Year Acquired | Original Cost \$ | Amount Existing Liens \$ | Purpose of Refinance | Describe Improvements <input type="checkbox"/> made <input type="checkbox"/> to be made |
| | | | | Cost \$ |

| | | |
|---|------------------------------------|--|
| Title will be held in what Name(s) | Manner in which Title will be held | Estate will be held in: <input checked="" type="checkbox"/> Fee Simple <input type="checkbox"/> Leasehold (show expiration date) |
| Source of Down Payment, Settlement Charges and/or Subordinate Financing (explain) | | |

Borrower

III. BORROWER INFORMATION

Co-Borrower

| | | | | | | | |
|---|------------------------------|---|-------------|---|------------------------------|--|-------------|
| Borrower's Name (include Jr. or Sr. if applicable) | | | | Co-Borrower's Name (include Jr. or Sr. if applicable) | | | |
| Social Security Number | Home Phone (incl. area code) | Age | Yrs. School | Social Security Number | Home Phone (incl. area code) | Age | Yrs. School |
| <input type="checkbox"/> Married <input type="checkbox"/> Unmarried (include single, divorced, widowed) <input type="checkbox"/> Separated | | Dependents (not listed by Co-Borrower) no. ages | | <input type="checkbox"/> Married <input type="checkbox"/> Unmarried (include single, divorced, widowed) <input type="checkbox"/> Separated | | Dependents (not listed by Borrower) no. ages | |
| Present Address (street, city, state, ZIP) <input type="checkbox"/> Own <input type="checkbox"/> Rent ___ No. Yrs. | | | | Present Address (street, city, state, ZIP) <input type="checkbox"/> Own <input type="checkbox"/> Rent ___ No. Yrs. | | | |

If residing at present address for less than two years, complete the following:

| | |
|---|---|
| Former Address (street, city, state, ZIP) <input type="checkbox"/> Own <input type="checkbox"/> Rent ___ No. Yrs. | Former Address (street, city, state, ZIP) <input type="checkbox"/> Own <input type="checkbox"/> Rent ___ No. Yrs. |
| Former Address (street, city, state, ZIP) <input type="checkbox"/> Own <input type="checkbox"/> Rent ___ No. Yrs. | Former Address (street, city, state, ZIP) <input type="checkbox"/> Own <input type="checkbox"/> Rent ___ No. Yrs. |

Borrower

IV. EMPLOYMENT INFORMATION

Co-Borrower

| | | | |
|---|---|---|---|
| Name and Address of Employer <input type="checkbox"/> Self Employed | Yrs. on this job | Name and Address of Employer <input type="checkbox"/> Self Employed | Yrs. on this job |
| | Yrs. employed in this line of work/profession | | Yrs. employed in this line of work/profession |
| Position/Title/Type of Business | Business Phone (incl. area code) | Position/Title/Type of Business | Business Phone (incl. area code) |

If employed in current position for less than two years or if currently employed in more than one position, complete the following:

| | | | |
|---|----------------------------------|---|----------------------------------|
| Name and Address of Employer <input type="checkbox"/> Self Employed | Dates(from-to) | Name and Address of Employer <input type="checkbox"/> Self Employed | Dates(from-to) |
| | Monthly Income \$ | | Monthly Income \$ |
| Position/Title/Type of Business | Business Phone (incl. area code) | Position/Title/Type of Business | Business Phone (incl. area code) |
| Name and Address of Employer <input type="checkbox"/> Self Employed | Dates(from-to) | Name and Address of Employer <input type="checkbox"/> Self Employed | Dates(from-to) |
| | Monthly Income \$ | | Monthly Income \$ |
| Position/Title/Type of Business | Business Phone (incl. area code) | Position/Title/Type of Business | Business Phone (incl. area code) |

V. MONTHLY INCOME AND COMBINED HOUSING EXPENSE INFORMATION

| Gross Monthly Income | Borrower | Co-Borrower | Total | Combined Monthly Housing Expense | Present | Proposed |
|---|----------|-------------|-------|----------------------------------|---------|----------|
| Base Empl. Income* | \$ | \$ | \$ | Rent | \$ | \$ |
| Overtime | | | | First Mortgage (P&I) | | |
| Bonuses | | | | Other Financing (P&I) | | |
| Commissions | | | | Hazard Insurance | | |
| Dividends/Interest | | | | Real Estate Taxes | | |
| Net Rental Income | | | | Mortgage Insurance | | |
| Other (before completing, see the notice in "describe other income," below) | | | | Homeowner Assn. Dues | | |
| | | | | Other | | |
| Total | \$ | \$ | \$ | Total | \$ | \$ |

*Self Employed Borrower(s) may be required to provide additional documentation such as tax returns and financial statements.

Describe Other Income Notice: Alimony, child support, or separate maintenance income need not be revealed if the Borrower(B) or Co-Borrower(C) does not choose to have it considered for repaying this loan.

| B/C | Monthly Amount |
|-----|----------------|
| | \$ |
| | |
| | |

VI. ASSETS AND LIABILITIES

This statement and any applicable supporting schedules may be completed jointly by both married and unmarried Co-borrowers if their assets and liabilities are sufficiently joined so that the Statement can be meaningfully and fairly presented on a combined basis; otherwise separate Statements and Schedules are required. If the Co-Borrower section was completed about a spouse, this Statement and supporting schedules must be completed about that spouse also.

Completed Jointly Not Jointly

| ASSETS | | LIABILITIES | |
|---|----------------------|--|--------------------------------|
| Description | Cash or Market Value | Name and address of Company | Monthly Payt. & Unpaid Balance |
| Cash deposit toward purchase held by: | \$ | | |
| <i>List checking and savings accounts below</i> | | | |
| Name and address of Bank, S&L, or Credit Union | | | |
| Acct. no. | \$ | | |
| Name and address of Bank, S&L, or Credit Union | | | |
| Acct. no. | \$ | | |
| Name and address of Bank, S&L, or Credit Union | | | |
| Acct. no. | \$ | | |
| Name and address of Bank, S&L, or Credit Union | | | |
| Acct. no. | \$ | | |
| Name and address of Bank, S&L, or Credit Union | | | |
| Acct. no. | \$ | | |
| Stocks & Bonds (Company name/ number & description) | \$ | | |
| Life insurance net cash value | | | |
| Face amount: \$ | \$ | | |
| Subtotal Liquid Assets | \$ | | |
| Real estate owned (enter market value from schedule of real estate owned) | \$ | | |
| Vested interest in retirement fund | \$ | | |
| Net worth of business(es) owned (attach financial statement) | \$ | | |
| Automobiles owned (make and year) | \$ | | |
| Other Assets (itemize) | \$ | Alimony/Child Support/Separate Maintenance Payments Owed to: | \$ |
| | | Job Related Expense (child care, union dues, etc.) | \$ |
| | | Total Monthly Payments | \$ |
| Total Assets a. | \$ | Net Worth (a-b) | \$ |
| | | Total Liabilities b. | \$ |

VI. ASSETS AND LIABILITIES (cont.)

Schedule of Real Estate Owned (if additional properties are owned, use continuation sheet.)

| Property Address (enter S if sold, PS if pending sale or R if rental being held for income) | Type of Property | Present Market Value | Amount of Mortgages & Liens | Gross Rental Income | Mortgage Payments | Insurance, Maintenance, Taxes & Misc. | Net Rental Income |
|---|------------------|----------------------|-----------------------------|---------------------|-------------------|---------------------------------------|-------------------|
| | | \$ | \$ | \$ | \$ | \$ | \$ |
| | | | | | | | |
| | | | | | | | |
| | Totals | \$ | \$ | \$ | \$ | \$ | \$ |

List any additional names under which credit has previously been received and indicate appropriate creditor name(s) and account number(s):

| Alternate Name | Creditor Name | Account Number |
|----------------|---------------|----------------|
| | | |

| VII. DETAILS OF TRANSACTION | | VIII. DECLARATIONS | | | | |
|---|----|---|--------------------------|--------------------------|--------------------------|--------------------------|
| a. Purchase price | \$ | If you answer "yes" to any questions a through i, please use continuation sheet for explanation. a. Are there any outstanding judgments against you? b. Have you been declared bankrupt within the past 7 years? c. Have you had property foreclosed upon or given title or deed in lieu thereof in the last 7 years? d. Are you a party to a lawsuit? e. Have you directly or indirectly been obligated on any loan which resulted in foreclosure, transfer of title in lieu of foreclosure, or judgment? (This would include such loans as home mortgage loans, SBA loans, home improvement loans, educational loans, manufactured (mobile) home loans, any mortgage, financial obligation, bond, or loan guarantee. If "Yes," provide details, including date, name and address of Lender, FHA or VA case number, if any, and reasons for the action.) f. Are you presently delinquent or in default on any Federal debt or any other loan, mortgage, financial obligation bond, or loan guarantee? If "Yes," give details as described in the preceding question. g. Are you obligated to pay alimony, child support, or separate maintenance? h. Is any part of the down payment borrowed? i. Are you a co-maker or endorser on a note? j. Are you a U. S. citizen? k. Are you a permanent resident alien? l. Do you intend to occupy the property as your primary residence? If "Yes," complete question m below. m. Have you had an ownership interest in a property in the last three years? (1) What type of property did you own-principal residence (PR), second home (SH), or investment property (IP)? (2) How did you hold title to the home-solely by yourself (S), jointly with your spouse (SP), or jointly with another person (O)? | Borrower | | Co-Borrower | |
| b. Alterations, improvements, repairs | | | Yes | No | Yes | No |
| c. Land (if acquired separately) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| d. Refinance (incl. debts to be paid off) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| e. Estimated prepaid items | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| f. Estimated closing costs | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| g. PMI, MIP, Funding Fee | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| h. Discount (if Borrower will pay) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. Total costs (add items a through h) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| j. Subordinate financing | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| k. Borrower's closing costs paid by Seller | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| l. Other Credits(explain) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| m. Loan amount (exclude PMI, MIP, Funding Fee financed) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| n. PMI, MIP, Funding Fee financed | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| o. Loan amount (add m & n) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| p. Cash from/to Borrower (subtract j, k, l & o from i) | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

IX. ACKNOWLEDGMENT AND AGREEMENT

The undersigned specifically acknowledge(s) and agree(s) that: (1) the loan requested by this application will be secured by a first mortgage or deed of trust on the property described herein; (2) the property will not be used for any illegal or prohibited purpose or use; (3) all statements made in this application are made for the purpose of obtaining the loan indicated herein; (4) occupation of the property will be as indicated above; (5) verification or reverification of any information contained in the application may be made at any time by the Lender, its agents, successors and assigns, either directly or through a credit reporting agency, from any source named in this application, and the original copy of this application will be retained by the Lender, even if the loan is not approved; (6) the Lender, its agents, successors and assigns will rely on the information contained in the application and I/we have a continuing obligation to amend and/or supplement the information provided in this application if any of the material facts which I/we have represented herein should change prior to closing; (7) in the event my/our payments on the loan indicated in this application become delinquent, the Lender, its agents, successors and assigns, may, in addition to all their other rights and remedies, report my/our name(s) and account information to a credit reporting agency; (8) ownership of the loan may be transferred to successor or assign of the Lender without notice to me and/or the administration of the loan account may be transferred to an agent, successor or assign of the Lender with prior notice to me; (9) the Lender, its agents, successors and assigns make no representations or warranties, express or implied, to the Borrower(s) regarding the property, the condition of the property, or the value of the property.

Certification: I/We certify that the information provided in this application is true and correct as of the date set forth opposite my/our signature(s) on this application and acknowledge my/our understanding that any intentional or negligent misrepresentation(s) of the information contained in this application may result in civil liability and/or criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Section 1001, et seq. and liability for monetary damages to the Lender, its agents, successors and assigns, insurers and any other person who may suffer any loss due to reliance upon any misrepresentation which I/we have made on this application.

| | | | |
|----------------------|------|-------------------------|------|
| Borrower's Signature | Date | Co-Borrower's Signature | Date |
| X | | X | |

X. INFORMATION FOR GOVERNMENT MONITORING PURPOSES

The following information is requested by the Federal Government for certain types of loans related to a dwelling, in order to monitor the Lender's compliance with equal credit opportunity, fair housing and home mortgage disclosure laws. You are not required to furnish this information, but are encouraged to do so. The law provides that a Lender may neither discriminate on the basis of this information, nor on whether you choose to furnish it. However, if you choose not to furnish it, under Federal regulations this Lender is required to note race and sex on the basis of visual observation or surname. If you do not wish to furnish the above information, please check the box below. (Lender must review the above material to assure that the disclosure satisfy all requirements to which the Lender is subject under applicable state law for the particular type of loan applied for.)

| | | | |
|------------------------------|---|--|---|
| BORROWER | <input type="checkbox"/> I do not wish to furnish this information | CO-BORROWER | <input type="checkbox"/> I do not wish to furnish this information |
| Race/National Origin: | <input type="checkbox"/> American Indian or Alaskan Native <input type="checkbox"/> Black, not of Hispanic origin <input type="checkbox"/> Hispanic <input type="checkbox"/> Other (specify) _____ | <input type="checkbox"/> Asian or Pacific Islander <input type="checkbox"/> White, not of Hispanic origin <input type="checkbox"/> Hispanic origin | <input type="checkbox"/> American Indian or Alaskan Native <input type="checkbox"/> Black, not of Hispanic origin <input type="checkbox"/> Hispanic <input type="checkbox"/> Other (specify) _____ |
| Sex: | <input type="checkbox"/> Female <input type="checkbox"/> Male | Sex: | <input type="checkbox"/> Female <input type="checkbox"/> Male |

| | | |
|--|--|---|
| To be Completed by Interviewer | Interviewer's Name (print or type) | Name and Address Interviewer's Employer |
| This application was taken by: | Interviewer's Signature | Date |
| <input type="checkbox"/> face-to-face interview <input type="checkbox"/> by mail <input type="checkbox"/> by telephone | Interviewer's Phone Number (incl. area code) | |

Continuation Sheet/Residential Loan Application

Use this continuation sheet if you need more space to complete the Residential Loan Application. Mark B for Borrower or C for Co-Borrower.

| | |
|--------------|---------------------|
| Borrower: | Agency Case Number: |
| Co-Borrower: | Lender Case Number: |

I/We fully understand that it is a Federal crime punishable by fine or imprisonment, or both, to knowingly make any false statements concerning any of the above facts as applicable under the provisions of Title 18, United States Code, Section 1001, et seq.

| | | | |
|-----------------------|------|--------------------------|------|
| Borrower's Signature: | Date | Co-Borrower's Signature: | Date |
| X | | X | |